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AFG's response to the IOSCO's consultation report on "Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives"

The Association Française de la Gestion financière (AFG)¹ welcomes the opportunity given by the IOSCO to express the French asset management's opinion on the proposed risk mitigation standards for non-centrally cleared OTC derivatives.

AFG supports IOSCO's initiatives to enhance financial stability and reduce risk in the non-centrally cleared OTC derivatives market. In Europe, to increase the transparency of the derivatives market and reduce the risk induced by bilateral transactions, EMIR already

¹ The Association Française de la Gestion financière (AFG)¹ represents the France-based investment management industry, both for collective and discretionary individual portfolio managements.

Our members include 411 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing 2600 billion euros in the field of investment management, making in particular the French industry the leader in Europe in terms of financial management location for collective investments (with nearly 1600 billion euros managed from France, i.e. 23% of all EU investment funds assets under management), wherever the funds are domiciled in the EU, and second at worldwide level after the US. In the field of collective investment, our industry includes – beside UCITS – the employee savings schemes and products such as regulated hedge funds/funds of hedge funds as well as a significant part of private equity funds and real estate funds. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

imposes reporting requirements and procedures on immediate confirmation, reconciliation, daily valuation, dispute resolution and compression.

COMMENTS

The IOSCO's consultation report incorporates the principles of EMIR regulation. Please find our general remarks that refer not only to the standards in the IOSCO's consultation.

- I. AFG supports the BCBS and IOSCO's final report of September 2013 and in particular:
 - a. The phase in period from 2015 to 2019,
 - b. The exclusion of counterparties that have less than 8 billion € notional amount of non-cleared derivatives,
 - c. The reduction of the margin requirement by 50 million,
 - d. The reaffirmation that funds are independent entities,
 - e. The preference for a large range of eligible collateral provided that appropriate haircuts are determined.

However, we suggest that the initial phase-in period starts after the obligation to compensate IRS is implemented, which should be, in Europe, second half of 2015 for CCP member firms and one year later for other financial institutions.

- II. Proportionality should be mentioned in the standards: proportionality to the level of risk appears as a possibility for Authorities in paragraph 1.4 of the consultation report. It should in our view be put as a strong principle covering all standards. More specifically, we would recommend that it be explicitly referred to in standards 1 and 8: the addition of the words "in a proportionate manner" at the end of both standards would be sufficient. In standard 7, the reference to the materiality test that is mentioned in paragraph 7.1 could also be included in the standard itself.
- III. No back loading of existing deals: AFG insists on the fact that, at the time of implementation of an obligation to collateralize, existing OTC derivative transactions should remain out of scope. The modification of such an important parameter as the collateral will undoubtedly change the economic equilibrium of the transaction and put counterparties in an unnecessarily difficult position.
- IV. Genuine amendment is not novation: furthermore, when an item of a transaction is amended it should not be considered as a novation that implies, if done after the implementation date, a modification in the collateral policy of the deal. Here again it would impair the economics of the initial transaction and the consequence in absence of clarification would be a deterioration of the price for the investor (the fund in our case) because the counterparty might include the risk of a modification in its initial

pricing. Of course, it should not enable counterparties to avoid collateralisation through a succession of amendments. The reference to “genuine amendments” as defined in the BCBS and IOSCO’s final report (paragraph 8.9 and footnote 20, p24) would be effective to limit the risk of circumvention of the regulation. To bring an example, structured funds may rely on a total return swap that will have a notional amount equivalent to the Assets of the fund; when holders redeem (and we see it at a rate of some percentage points yearly) despite their initial agreement to invest till the maturity of the fund, the size of the swap must be adjusted: it is typically a transaction that should not be considered as a novation.

- V. Reporting: reporting is a common practice in some countries (i.e.: in the USA and in different European and Asian countries). However, we suggest that it be reaffirmed as a standard that enables authorities to gain a global view on OTC derivative transactions. Furthermore, the standard should introduce the idea that aggregating all reporting in one single repository will be a necessity and should be organized.

- VI. Investor’s protection: AFG would like standards to refer to the organisational procedures for exchange of collateral. These are essentials to ensure proper protection to counterparties. More specifically, we think that:
 - a. collateral should be defined as a deposit of cash or eligible securities made on an account that both grants to the beneficiary direct access to the collateral in case of default of its counterparty and reversely protects the constituent from the failure of its counterparty;
 - b. the principle of exchange of initial margin by both sides should be reaffirmed;
 - c. the possibility to use a third party depository to avoid counterparty risk by the amount of the margin deposited should be clearly referred to as a good practice and authorities should be recommended to introduce it.

- VII. Valuation: the recommendations in the paragraphs 4.4 and 4.8 seem more restrictive than the EMIR regulation and they do not appear useful to us. AFG considers that in case of unavailability of valuation the only efficient recommendation under the paragraph 4.8 would be for counterparties to discuss and agree on a common decision. Any alternative method or source may just not be available either at the time of deficiency of the original method. Moreover, AFG thinks that the agreement between counterparties referred to in paragraph 4.7 should include also sources of data, which it are a key element for valuation.

If you need any further information, please don't hesitate:

- to read the AFG comments to the Joint Committee of the European Supervisory Authorities' consultation paper on the Draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648//2012
http://www.afg.asso.fr/index.php?option=com_content&view=article&id=5523&Itemid=475&lang=fr&limitstart=2

and/or

- to contact Eric Sidot (e.sidot@afg.asso.fr), or myself (e.pagniez@afg.asso.fr).

Sincerely Yours,

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