Frankfurt am Main
16 December 2014

BVI position on BCBS/IOSCO Consultation Report on Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives

BVI[1] gladly takes the opportunity to present its views on the BCBS/IOSCO consultation report on risk mitigation standards for non-centrally cleared OTC derivatives.

We support the initiative by BCBS/IOSCO to establish risk mitigation standards for non-centrally cleared OTC derivatives which will further complement the recommendation for margin requirements published in September 2013. The proposed standards for risk mitigation techniques will increase legal certainty and facilitate the management of counterparty credit and other risk, thereby enhancing the overall stability of the financial system. We share the view of BCBS/IOSCO that the standards should be sufficiently compatible across jurisdictions in order to avoid regulatory arbitrage, maintaining a level playing field for all market participants.

We would like to make the following comments:

(a) Are the proposed risk mitigation standards generally appropriate in light of the objectives? Are there any particular standards you consider to be inappropriate for inclusion? Please provide rationale.

(b) Are the key considerations appropriate and consistent with the standards? Are there elements of the key considerations that should instead be included in the standards? Are there additional or alternative key considerations that should be considered for each standard? If so, please describe them and explain why they should be included.

The proposed risk mitigation standards and the associated key considerations are altogether carefully calibrated related to the stated objectives. However, the proposed standards set only highly non-binding recommendations which will be further detailed through a regulation supplemented by market standards/master agreements. In Europe, the proposed standards are implemented through the EMIR framework. German investment fund management companies acting on behalf of highly regulated investment funds (UCITS/AIF) have already put in place legal and operational procedures/processes in order to adhere to the risk mitigation standards as laid down in EMIR.

The development of such legal and operational arrangements is a very complex task which needs resources in terms of staff, time and investments. We trust that BCBS/IOSCO acknowledges that the EMIR risk mitigation standards are high quality cornerstones of the European framework. The application of the EMIR risk mitigation standards applied by the financial counterparties (UCITS/AIF) should be in general considered compliant with the proposed standards.

Related to the standards, we would like to make the following specific remarks:

[1] BVI represents the interests of the German investment fund and asset management industry. Its 83 members manage assets in excess of EUR 2.2 trillion in retail funds, institutional funds and asset management mandates. As such, BVI is committed to improving the overall conditions for investors, while at the same time promoting a level playing field for all investors across all financial markets. BVI members manage, directly or indirectly, the assets of 50 million private clients over 21 million households. (BVI's ID number in the EU Transparency Register is 96816064173-47). For more information, please visit www.bvi.de.

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- **Standard 2: Trading Relationship Documentation : Para 2.6**

The proposed content of the trading relationship documentation is partially covered by the ISDA Master Agreements and the German Master Agreements. According to our understanding the following requirements are new: rehypothecation terms, custodial arrangements for margin assets, including whether margin assets are to be segregated with a third party custodian. Furthermore, the recording requirements for the trading relationship documentation should not impose new obligations on top of existing national provisions.

- **Standard 3: Trade Confirmation: Annex 1: Possible Material Terms for Confirmation**

The date fields mentioned in Annex 1 are already implemented by EMIR and used by the market participants. Therefore, we expect that the mentioned data fields should be compliant with the EMIR data fields used in the trade confirmation process.

- **Standard 6: Portfolio Compression**

A portfolio compression should only be applied with concrete thresholds. We support to take the thresholds provided in EMIR as a starting point. Otherwise, a reconciliation of portfolio positions between the counterparties to a concluded derivative transaction below a threshold is too cumbersome and without any benefit neither for the market nor for financial stability.

(c) Are there standards or key considerations that should be further expounded on (e.g. specifying the deadlines for completion of trade confirmations under key consideration 3.2; the characteristics or parameters of what constitute "economically similar transactions" under key consideration 4.2; the frequency for conducting reconciliations under key consideration 5.1)?

No. Please see our answer to questions (a) and (b). EMIR sets precise obligations related to the deadlines for completion of trade confirmations and for conducting reconciliations. A further specification of related trade aspects as proposed in the trading relationship documentation should be left to market standards/master agreements.

(d) Are there additional or alternative relevant risk mitigation techniques that should be considered and implemented to reduce the risks arising from non-centrally cleared OTC derivatives transactions? If so, please describe them and explain why they should be considered.

No. The proposed standards should form together with the margin requirements the global framework for non-centrally cleared derivatives. As mentioned above, those standards set only highly non-binding recommendations which should be further detailed through a general regulatory framework and be supplemented by market standards/master agreements.

(e) What are the practical challenges in implementing the standards? Please substantiate the issues identified and propose solutions to these challenges.

Please see our answers to questions (a) and (b). The conclusion of (new) legal arrangements between the investment fund management company and the counterparty (e.g. a credit institution) involves the incorporation of additional fund related legal aspects which goes beyond the standard master agreements provided by ISDA and the Association of German Banks.

(f) Are the proposed risk mitigation standards compatible with obligations arising under other international standards applicable to non-centrally cleared OTC derivatives, such as the margin requirements for non-centrally cleared OTC derivatives published by IOSCO and BCBS in September 2013? If not, please identify the relevant standards and explain any areas of incompatibility.

We fear that Standard 4 "Valuation with Counterparties" could impose additional restrictions on the financial counterparties (UCITS/AIF) to agree and exchange the valuation methodology and the related determining factors (e.g. input parameters etc) ahead of the start and during the whole lifetime of non-centrally cleared derivatives. The input parameters of the valuation methodologies could vary due to different assumptions applied by the financial counterparties to a concluded contract. For example, both counterparties could have differing views on the recovery rate for CDS contracts. The recovery rate for CDS spreads can also fluctuate between incumbent data vendors for illiquid underlyings.

Financial counterparties (UCITS/AIF) use as parameters for the valuation methodology the input data provided by the data vendors (e.g. Bloomberg, Markit). UCITS/AIFs are only allowed to pass on the input data to the counterparties if they signed a valid data license agreement with the relevant data vendors. The requirement as proposed in Standard 4 to transmit the input data to the counterparties could enhance the license costs for UCITS/AIFs as they have to extend their data license.

Furthermore, the proposed valuation standard 4 is partially covered by the margin requirement 3 (variation margin) for non-centrally cleared derivatives published in September 2013. Therefore, as mentioned above, the proposed standard can set only a high level recommendation which should also be aligned with the margin requirement 3.