efama

European Fund and Asset Management Association

EFAMA response to BCBS-IOSCO consultation report on the initial policy proposals on Risk Mitigation Standards for Non-centrally Cleared Over-the-counter (OTC) Derivatives

EFAMA[1] welcomes the opportunity to submit comments on the BCBS-IOSCO consultation report on the initial policy proposals on Risk Mitigation Standards for Non-centrally Cleared Over-the-counter (OTC) Derivatives. EFAMA considers this initiative as very positive and fully supports the initiatives aimed at enhancing safety and transparency in the over-the-counter derivatives market.

Although we agree with many key ideas and principles, we wish to submit the following general remarks (see section I) before providing our answers to the consultation (see Section II).

We would like to refer also to our replies that we gave to the BCBS-IOSCO consultation on margin requirements for non-centrally-cleared derivatives.

Section I – General remarks

EFAMA supports the initiative by BCBS/IOSCO to establish risk calculation methods and risk mitigation standards in a number of financial sectors and financial activities.

We agree with the proposed standards for risk mitigation techniques (which complement the recommendation for margin requirements published in September 2013) as it will increase legal certainty and facilitate the management of risks, especially counterparty risk.

We also support BCBS/IOSCO's view that those proposed standards should be compatible across jurisdiction to the largest possible extend. We consider this approach as the sole way to ensure cross-border legal certainty and to avoid regulatory arbitrage.

However, we believe that the proposed standards should not have any type of binding nature.

[1] EFAMA is the representative association for the European investment management industry. EFAMA represents through its 27 member associations and 63 corporate members almost EUR 17 trillion in assets under management of which EUR 10.6 trillion managed by 55,000 investment funds at end June 2014. Just under 36,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds. For more information about EFAMA, please visit www.efama.org

rue Montoyer 47, B-1000 Bruxelles
☎ +32 2 513 39 69 • Fax +32 2 513 26 43 • e-mail : info@efama.org • www.efama.org • VAT Nr BE 0446.651.445

Indeed, in Europe, the proposed standards are implemented through EMIR. European regulated funds (such as UCITS or AIF) and asset managers have already adapted their business models and IT systems according to this regulation.

Consequently, we strongly believe that BCBS-IOSCO should take this reality into account and recognises that those regulated funds and asset managers are compliant with the proposed standards, even if the proposed standards are set at an international level,

Section II – EFAMA's answers to the consultation

(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.

EFAMA believes that the proposed standards and related considerations are, generally speaking, duly related to the objectives expressed in the consultation.

However, as mentioned in our general comments, we strongly believe that the proposed standards should only be set in non-binding recommendations.

Different regulatory frameworks are already in place to implement the objectives imposed by G-20. For example, EMIR sets in place those requirements at European level. In application of EMIR, regulated funds and asset managers have already put in place legal and operational architectures required to meet EMIR requirements.

In particular, EFAMA fears that Standard 4[2] could impose additional or different restrictions on the regulated funds to agree and exchange the valuation methodology (e.g. through different definitions of the recovery rate ratios of credit derivatives).

Currently, the related determination parameters of the valuation methodologies vary, depending on the counterparties. Those valuations are based on paying data models. The requirement proposed in Standard 4 could then considerably increase the license costs for the regulated funds due to the necessary extension of their data licenses to their different counterparties.

[2] Standard 4 - Valuation with Counterparties

Additionally, as the valuation requirements for margins are partly covered by the recommendation 3 published in September 2013, we believe that this standard should be reduced to a minimal recommendation which should also be aligned with recommendation 3.

(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)?

We do not think so and would rather urge BCBS-IOSCO to recognise the equivalence of its proposed policy with EMIR.

Indeed, EMIR already sets precise obligations for the confirmation or the reconciliation of transactions.
Setting other rules would create either legal uncertainty, regulatory arbitrage or conflicting rules.

Additionally, we would like also to remind that national or market standards already exists and that those recognised standards should also be taken into account.

(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.

EFAMA believes that the framework must be global and should cover the margin requirements together with risk mitigation measures.

As explained above (see our reply to the first questions), the global framework for non-centrally cleared derivatives proposed should only be in the format of non-binding recommendations. Those recommendations should be detailed through a broad regulatory framework and be complemented through the of use market standards or national legal agreements.

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

European regulated funds such UCITS or AIFs have already developed and implemented legal and operational procedures to meet EMIR requirements.

The cost related to the implementation of these developments is high. Being imposed new and similar but not identical criteria would increase the costs that would have to be transferred at least partly on the investors.

Additionally, a difference between the regimes would create legal risks and legal costs considering the number of contracts that would have to be modified.

(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.

Please see our answer to question 2.

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Brussels, 17 October 2014

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