17 October 2014

Ken Hui
International Organisation of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Sent by email to: consultation-2014-06@iosco.org

Dear Mr Hui,

IOSCO Consultation Report on Risk Mitigation Standards for Non-centrally Cleared OTC derivative trades

The Investment Management Association (IMA) represents the asset management industry operating in the UK. Our members include independent asset managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around GBP 5 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

We welcome IOSCO's initiative to implement common risk mitigation standards for non-centrally cleared OTC derivative trades and the opportunity to comment on the Consultation Report. Our responses to each question are attached to this letter.

If you would like to discuss the issues raised in more detail, please contact Peter Capper (Peter.Capper@investmentuk.org).

Yours sincerely

Peter Capper
Adviser, Product Regulation
Investment Management Association

IMA Response to IOSCO Consultation Report on Risk Mitigation Standards for Non-centrally Cleared OTC derivative trades

(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.

We largely agree "the proposed risk mitigation standards are generally appropriate in light of the objectives".

We do, however, have reservations about the wording of "Standard 8: Implementation". While we welcome the intention that national competent authorities (NCAs) should implement the standards "as soon as practicable", in practice it may take some time to implement the standards. The likely outcome of too short an implementation period would be rushed, poorly drafted regulation and inconsistencies across different regimes, which could result in regulatory arbitrage, variation of standards and conflicting regimes in cross border transactions. In addition, this timeframe does not allow sufficient time for system development or for the redrafting of contractual agreements both of which will require significantly longer than the time implied.

We would therefore recommend amending standard 8 to "Authorities should implement the standards described in this paper within a reasonable timeframe [and by [year] at the latest]."

(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.

While not necessarily inconsistent with the standards, we note that in some instances requirements appear to be set out in the explanatory notes. Some examples of his are as follows:

- Paragraph 1.7 of Standard 1 states a requirement for the covered entity to conduct due diligence at the outset and on an on-going basis on any third party service provider it employs, and states responsibility for compliance cannot be delegated by the covered entity.
- Paragraphs 3.5 – 3.7 of Standard 3 list various requirements relating to the material terms that should be disclosed in the trade confirmation, timescales and entry confirmation.
- Paragraph 4.8 of Standard 4 states a requirement for valuation documentation to include alternative methods. (Although please note our further comments regarding this standard.)

In our view requirements such as these should be included in the key considerations rather than the explanatory notes for the purposes of clarity.

(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)?

In order to ensure a consistency of approach globally, the standards will need to limit the scope for flexibility and interpretation. As currently proposed, the standards provide too much scope for such flexibility and interpretation. As such, we would request that common requirements are agreed, particularly in the following key areas:

- "Financial entities" and "systemically important non-financial entities" – a common interpretation of these terms should be determined at international level.
- A common scope of application among market participants should be determined – paragraph 1.4 of Standard 1 leaves too much to be determined at national level by NCAs, and is therefore likely to result in inconsistent application.
- Content of trade confirmations – we would suggest that the table in Annex 1 is used as the basis for specifying the minimum terms that should be disclosed in trade confirmations (although not necessarily to the exclusion of other terms).
- Deadlines for trade confirmations – a maximum deadline for these should be specified in paragraph 3.6.
- Frequency of portfolio reconciliations – a minimum frequency for portfolio reconciliations should be determined at international level in paragraph 5.6.
- Parameters for reporting of disputes to NCAs – in paragraph 7.4 it would be helpful for NCAs to determine at international level the thresholds and outstanding period to apply before the relevant NCA is required to be notified of the dispute.

In addition, while we support the principle of Standard 9, that authorities should interact to minimise differences in risk mitigation requirements, we are concerned that such a statement on its own would be insufficient to achieve this objective. We would therefore support a more direct role for IOSCO to engage with and mediate between NCAs to agree a common application (as far as possible) of the risk mitigation requirements in order to minimise such differences and inconsistencies between NCAs.

(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.

We do not believe any additional requirements should be considered at international level.

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

Standard 8: As noted in our response to question (a), implementing the standards will require a reasonable timeframe to ensure the appropriate legislation and regulations can be implemented by NCAs in a manner that is robust and internationally consistent, and to allow practitioners reasonable time to develop and test robust systems and re-paper contracts.

As such, we do not believe that the timeframe indicated in paragraph 8.3 for NCAs to implement the standards by 1 December 2015 is realistic. We believe an implementation

period of around three to five years is more realistic, allowing sufficient time for NCAs to develop and implement robust regulations that are consistent with those of other jurisdictions and for a more realistic timetable for practitioners to develop and test systems and re-paper legal contracts.

Standard 4: The requirements outlined in the key considerations and explanatory notes raise some practical concerns. Firstly, the requirement for covered entities to agree a valuation process and /or methodology may be difficult to implement in practice. If it is agreed that one counterparty's valuation methodology will be used, the other covered entity will require sufficient details in order to approve and implement this process itself which the counterparty is unlikely to be willing to disclose. While footnote 10 states that "no OTC derivatives market participant should be required to disclose to its counterparty confidential, proprietary information about any model it may use to value an OTC derivative transaction", a level of disclosure would be required beyond what counterparties may be prepared to disclose.

Secondly, the requirement in paragraph 4.8 requiring covered entities to have alternative methodology for determining value in the event of unavailability of other inputs is potentially problematic. Covered entities may struggle to obtain commitment from counterparties to guarantee provision of prices on certain positions in events of severe market disruption – in such circumstances, their counterparty may not be willing to provide a prices externally even if it is able to calculate a price for the purposes of valuing its own positions. For complex positions, a number of covered entities would not have the capability to value these positions themselves in such scenarios and may not be able to source a price.

The approach adopted by the European Market Infrastructure Regulation (EMIR), where financial counterparties and Non-Financial Counterparty above the threshold (NFC+) are required to conduct daily valuations using mark-to-market or mark-to-model (using set criteria), but where counterparties are not required to agree the valuation methodology, is more realistic. Under this approach, agreement would still be required as to which counterparty's valuation is used at key events, such as at maturity or termination, and also for the counterparties to agree on a margin calculation method.

(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 have not identified any incompatibilities with other international standards.