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**Your Ref: Comment letter on Consultation Report  
- Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives**

Dear Mr. Hui.

Thank you very much for giving us the opportunity to comment on your consultation report (CR06/2014) on: Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives. The report proposes nine standards for risk mitigation techniques for non-centrally cleared derivatives with the aim of: promoting legal certainty and facilitating timely dispute resolution; facilitating the management of counterparty credit and other risks; and increasing overall financial stability. I agree that these standards, together with suitable margin requirements for non-centrally cleared derivatives, will promote financial strength and stability, foster efficient processes and improve risk management practices thereunder, and further reduce systemic risk in the OTC derivatives market.

Standard 4: Valuation with Counterparties

Covered entities would be required to agree on and clearly document the processes and/or methodology for determining the value of each non-centrally cleared OTC derivatives transaction at any time. I support that the agreed processes and/or methodology should be required to constitute an objectively verifiable methodology for valuing each non-centrally cleared OTC derivatives transaction. This will increase transparency, operational efficiency and assist in the early and objective resolution of non-centrally cleared OTC derivatives valuation disputes, thus supporting Standard 7 on Dispute Resolution. I would further recommend that the Standard should additionally require that the methodology must include alternatives in the event that one or more inputs become unavailable. I suggest that such a modified Standard would support a further requirement for covered entities to resolve a dispute over the valuation of a non-centrally cleared OTC derivative within a reasonable period of time.

I would strongly recommend not to prescribe any valuation methodology, and I prefer freedom with disclosure here. This would seem to be achievable given a requirement that the methodology should be objectively verifiable. In any event, certain non-centrally cleared OTC derivatives rely on internal and/or proprietary inputs and methods for their valuation, and restricting this practice would be detrimental to market innovation and efficiency. Therefore, I support that the valuation processes and/or methodology should allow the use of internal and/or proprietary inputs and methods, subject to covered entities being required to disclose such information, and the sources thereof, to the counterparty and regulators in sufficient detail for them to undertake comparative analysis of such information and verify the valuation calculations.<sup>1</sup>

#### Standard 5: Reconciliation

I particularly support the proposed reconciliation requirements, which require covered entities to carry out portfolio reconciliation for their non-centrally cleared OTC derivatives. I also support that such portfolio reconciliation could be performed on a bilateral basis or by a qualified third party. Finally, I support the principle that the frequency of reconciliation should be tailored to the materiality and size of the non-centrally cleared OTC derivatives portfolio. For completeness and in order to provide a mechanism to shorten and simplify the policy process, I would support that portfolio reconciliation could be defined by generally accepted industry standards.

#### Standard 6: Portfolio Compression

I generally support the Standard on portfolio compression, which is an important post-processing and netting mechanism. However, it should be noted that portfolio compression is most beneficial in markets with highly homogeneous transactions, and large volumes of redundant trades. Therefore it is appropriate that this Standard does not mandate portfolio compression, but rather the establishment and implementation of policies and procedures to regularly assess portfolio compression opportunities, and then, to the extent appropriate, engagement in portfolio compression.

Yours sincerely

C.R. Barnard

Chris Barnard

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<sup>1</sup> However, I agree 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.