

ALFI comments on the ESMA / EBA / EIOPA Discussion Paper

on

**Draft Regulatory Technical Standards
on risk mitigation techniques for OTC derivatives not cleared by a CCP under the Regulation on
OTC derivatives, CCPs and Trade Repositories
(JC/DP/2012/1)**

London, Frankfurt, Paris

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ALFI represents the Luxembourg investment management and fund industry. It counts among its membership asset management groups from various horizons and a large variety of service providers. According to the latest CSSF (Commission de Surveillance du Secteur Financier) figures, on 29 February 2012, there are 3 847 undertakings for collective investment in Luxembourg (UCITS and non-UCITS), representing 13 334 active compartments representing a total, in terms of net asset value EUR 2 203.159 billion.

ALFI welcomes the ESMA / EBA / EIOPA discussion paper – Draft Regulatory Technical Standards on risk mitigation techniques for OTC derivatives not cleared by a CCP under the Regulation on OTC derivatives, CCPs and Trade Repositories.

Regarding these Draft Regulatory Technical Standards, the ALFI EMIR and OTC Derivatives Working Group has analyzed the document and has the following comments.

The Working Group decided not to answer to all the questions raised in this document however to transmit a few general elements or remarks.

1. The specific nature of UCITS is not really taken into account in the various questions and technical standards. UCITS are long term investment products purchased by retail and institutional investors across Europe. UCITS apply conservative investment policies, are subject to a strict regulation and therefore (even without EMIR or any collateralization) are highly safe financial entities. There is no recognition of mutual funds in the current legislation and the ALFI recommends that rules on margining and capital requirements are adapted to the funds' specifics.
2. Initial Margin requirements for OTC derivatives, not being cleared by a CCP, are neither requested by G-20 nor under EMIR. We deem it very laborious and expensive, if possible at all, implementing Initial Margins for OTC derivatives, not being cleared by a CCP. Due to the differing national property- and insolvency laws, it is not clear how a segregation in the manner described by the ESAs shall be realized at all. Due to the expected operational and monetary efforts the ESAs should reconsider if the counterparty risks to be covered by Initial Margins could instead be considered by allowing market participants to apply a haircut higher than the minimum haircut on collateral, as determined by the ESAs.

3. The ESAs also should consider the specifics of regulated investment funds with regards to the range of collateral eligible for OTC derivatives, not being cleared by a CCP. According to the already existing regulations, regulated investment funds such as UCITS only have very limited access to assets being eligible as collateral. Furthermore, differing from banks, regulated investment funds are not allowed to post collateral received from their counterparty as collateral to a third party. If the ESAs limit the range of assets eligible for collateralization, regulated investment funds might become unable to hedge existing risks or might consider purchasing other instruments like warrants and certificates subject to an issuer risk which cannot be collateralized. Therefore any limitation on collateral might provoke new risks, currently not existing. It is recommended that the regulator does not treat on the same level UCITS and other types of counterparties when it comes to margining requirements. It should consider the limitations already applicable to regulated investment funds, e.g. by drafting solutions like allowing regulated investment funds to net counterparty exposures arising from OTC derivatives in order to reduce the total of collateral to be posted by a regulated investment funds (which would not lead to an increased counterparty risk).
4. Consistency across various regulations. ALFI has to express concerns around the coordination across the various regulations that will impact investment funds and their investments in OTC derivatives. The regulator should make sure there are no overlap or contradictory rules in the various regulations. It is also questioned how global regulations will coexist with some local regulation that already deal with collateral requirements for UCITS.
5. Margin calculation method. We recommend applying consistent methods across the various participants to avoid any confusion and arbitrage in the margining process. UCITS should be treated as a specific category of counterparties and benefit from low risk ratings when it comes to posting margin to sell side institutions.
6. ALFI seeks clarification on how EMIR will work together with the US regulation on OTC derivatives so called Dodd-Frank Act Title VII. There is a strong recommendation to agree with US regulators on cross border impacts of the different rules before finalizing the RTS for EMIR. As an example, in case a Luxembourg investment vehicle enters into an OTC derivatives contract with a US broker/dealer or their European subsidiary, it is questioned what will be the applicable regulation and how the various rules will work together.
7. Regarding operational practice around collateral management, the industry has developed several legal and operational practices that should be leveraged as much as possible in the preparation of the new rules. It is recommended to avoid systematic daily exchange of collateral by allowing appropriate minimum transfer amounts.

Contact

For further information, do not hesitate to contact Antoine Kremer (<mailto:Antoine.kremer@abbl-alfi.lu>) or François Drazdik, Senior Industry Affairs Advisor at ALFI's headquarters in Luxembourg (francois.drazdik@alfi.lu; 00352 22 30 26-42).