PENSIOEN FEDERATIE

Federation of the Dutch
Pension Funds
Prinses Margrietplantsoen 90
2595 BR The Hague
PO Box 93158
2509 AD The Hague
The Netherlands
T +31 (0)70 76 20 220
info@pensioenfederatie.nl
www.pensioenfederatie.nl

KvK Haaglanden 40411428
Triodos Bank 212407368

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

International Organization of Securities Commissions
C/ Oquendo 12
28006 Madrid
Spain

REFERENCE: B/12/6596/SR DATE: September 28, 2012

SUBJECT: Response to the BCBS-IOSCO Consultative Document Margin requirements for non-centrally-cleared derivatives

Dear Madam, dear Sir,

1. Introductory Statement

"This response to the Consultative Document "Margin requirements for non-centrally-cleared derivatives" has been prepared by a working group of the Federation of the Dutch Pension Funds together with APG Asset Management, MN, PGGM Investment Management, Shell Asset Management and Syntrus Achmea. The latter are dedicated service providers of the largest Dutch pension funds. More information on both the Federation and these organisations, is included at the end of our response."

Dutch pension funds use large amounts of OTC derivatives with the objective of meeting the obligations of pension plans (by hedging asset or liability risks with the aim of minimizing volatility between assets and liabilities). They hedge their liabilities (pension cash flows) against inflation and interest rate risks to offer regulatory protection for pension beneficiaries. Pension funds do not speculate with derivatives. Article 18d of the IORP Directive 2003/41/EC) obliges pension funds to use derivatives for risk mitigation purposes. As a result, speculation is forbidden.

As users of OTC derivatives we welcome the opportunity to provide our views on the consultation document. We have provided our key remarks first and subsequently have answered the questions in more detail.

2. Key remarks

Upon request of the Dutch Central Bank (*De Nederlandsche Bank*), APG Asset Management and PGGM Investment Management, have responded separately to the quantitative impact assessment (QIS) that has been issued in this respect. The data show that the impact of the proposed requirements is extraordinarily high. According to the reported data, a <u>very substantial part</u> of the pension funds' assets would have to be used as collateral for initial margin (IM) purposes as a consequence of the proposed rules.

►For the reasons given below, we strongly request pension scheme arrangements within the meaning of EMIR (please see the <u>Appendix</u> for the exact definition as included in EMIR) to be exempted from IM posting requirements and respect the stability that pension funds provide to financial markets.

Pension funds are long term investors with a very prudent investment style. They have no structural debt or leverage. Pension funds have been very reliable institutions during the years of financial crises and have therefore been an important stabilizing factor.

We are supportive of measures to reduce systemic risks and to protect the financial system. However, we believe that measures aimed at reducing systemic risks will only contribute to that goal, if they are targeted at those counterparties that add risk to that system. Imposing unnecessary margin requirements on counterparties that do not increase the risk in the system will not help to achieve that goal. Any cost of such requirements will have to be borne by the current and future retirees, who actually will then be forced to pay for the risks that other market participants pose to the financial system.

Margin requirements should therefore take into account the specific characteristics of the different market participants involved in non-cleared derivatives transactions.

Pension funds and their dedicated investment vehicles should in our view <u>not</u> be subject to (initial) margin requirements <u>at all</u>, for the following reasons:

- Pension funds are highly creditworthy, conservatively managed, stable, long-term and non-commercial institutions.

They operate as entities which are non-profit legal entities controlled by employees' and employers' organisations. They are not part of any company or group nor do they have shareholders to whom they have to pay dividends. The Dutch workplace pension system has a mandatory character. Together with an extensive set of rules aimed at maintaining the financial soundness of the pension funds, the theoretical risk of the bankruptcy of a Dutch pension fund is very limited or even non-existent. (Dutch) Pension funds can mitigate risk by either (i) increasing the premiums, (ii) stop indexation of pensions, or (iii) decreasing payments to the pensioners. Therefore, banks do run practically no counterparty risk when entering into transactions with pension funds. Consequently, there are no valid arguments for applying IM posting requirements to the pension funds' OTC derivatives trade. This is the exact reason why currently *only* variation margin (**VM**) and no IM is exchanged with our counterparties, as they have determined that pension funds are low-risk counterparties, that do not pose material default risk. We would like to stress that we are not against the concept of IM per se, but believe that it should come at an acceptable cost and duly take into account the credit risk posed.

- As has been rightly indicated in the Consultative Document, IM and VM requirements should always be appropriate to the risks posed by the transactions. Even though some pension funds may be considered to be important market participants due to their size and the scale of their derivatives transactions, this does not necessarily mean that they contribute to systemic risk. On the contrary, pension funds' derivatives transactions can be deemed to actually *reduce* systemic risk due to the fact that they are such creditworthy counterparties, thus contributing to safe and stable markets. The creditworthiness of parties should thus primarily be taken into account. It seems to be an implicit assumption of the BCBS and IOSCO that key market participants always contribute to systemic risk, which is *not* the case.

- 'Pension scheme arrangements' as defined in article 2(10) of EMIR are exempted from mandatory clearing requirements (we refer to article 89 of EMIR), ensuring that pension scheme arrangements can continue to hedge their risks without such a disproportionate cost impact, at least as long as no solution has been found to post VM in a form other than cash.

In addition, in the EU the credit valuation adjustment charge that will be imposed on banks for bilateral uncleared derivatives trades will not apply to trades between banks and pension scheme arrangements during the period of the abovementioned exemption. Also in this respect, the creditworthiness of pension scheme arrangements has been recognized and has it been made clear that the positive effect from the EMIR clearing exemption should not be negated by capital charges for banks. It is for these same reasons that no margin requirements should be imposed on pension plans for uncleared swaps.

- It has been stated in the Consultative Document that imposing margin requirements may serve as an <u>incentive for mandatory clearing</u>, apparently even if the parties concerned would not be required to do so in the first place. If we understand the Consultative Documents correctly, institutions that do not fall within the scope of EMIR -for obvious and valid reasons, as is the case with pension scheme arrangements- may nonetheless be forced to go down the route of mandatory clearing because the alternative (i.e. entering into bilateral, non-centrally-cleared transactions) is becoming far more detrimental. We note that preliminary calculation exercises show that the currently proposed IM requirements would result in *substantially* higher costs for pension funds than if opting for mandatory clearing, while the temporary exemption as included in EMIR had already been created precisely to avoid a disproportionate cost impact on pension scheme arrangements. Costs that ultimately will be borne by the pensioners. In other words: <u>if an exemption is not granted in respect of the IM requirements for bilateral transactions, the EMIR exemption would in fact be made meaningless</u> and pension scheme arrangements would still incur such disproportionate costs.

- We also note that pension schemes arrangements may have obligations that can only be effectively hedged with customized transactions that are not clearable. Even if the clearing obligation applies, a substantial part of our derivatives transaction will not be clearable. In other words: exempting these entities from IM requirements, would not compromise the goal of promoting central clearing, as clearing will simply <u>not be an alternative option</u> for these transactions.

- OTC derivatives are a key risk mitigation tool for matching the duration of pension schemes assets with the duration of their liabilities. Pension funds use derivatives to manage risk and mitigate funded status volatility that would be harmful to participants in the pension schemes. The biggest risks faced by pension funds are interest rate and currency risks. Not hedging such risks would result in pensions being less well-funded and potentially less secure. Without hedging, we would expose ourselves and the (future) beneficiaries of our pension funds to significant volatility risk. That translates into higher costs and lower performance and pension returns. We do not use OTC derivatives to speculate or take a view on the market – as previously mentioned, as we are not even allowed to do so pursuant to the IORP Directive.

- Given their use as hedging instruments, pension scheme arrangements generally have very large and one sided OTC derivatives positions. Mandatory IM requirements would necessitate new and costly incremental funding requirements for pension scheme arrangements. The outcome of IM calculations would be very high, due to the fact that the derivatives transacted by pension scheme arrangements are typically long-dated and one directional, meaning very little offsetting options exist in the portfolio that would reduce the overall amount. Unlike derivatives dealers who have access to central bank liquidity, most pension scheme arrangements do not have expedient and low-cost access to liquidity sources.

- Given their large one-sided exposures, pension scheme arrangements are disadvantaged by not being able to manage IM compared to derivatives dealers, who generally see more trading flow with offsets and have a broader base of counterparties to allow for lower margin requirements. Again, while unintended, the impact of the IM requirements are disproportionately high for pension scheme arrangements. Forcing high levels of IM could potentially mean that pension scheme arrangements would have to set aside large cash reserves to meet margin rules, thereby starving off new investments in European and international companies.

- Two-way margining: we support two-way margining, but stress that it should be left at the ultimate discretion of the pension schemes arrangements whether or not to request for VM and/or IM to actually be posted in a particular transaction. If it is not opted for two way margining, we believe that only the less creditworthy party should post IM.

- IM models: it is very important that IM models will permit risk offsets *across* instruments and asset classes. Risk mitigation benefits arising from related trades cannot be denied and need to be taken into account.
  It is likely that most banks will use internal models to calculate IM, thus leading to less transparent markets. Different banks will require different IM's for the same transaction, resulting in prices no longer being comparable. We believe that this is an unintended, but negative consequence and in contradiction to the goal of safer markets.
  Many end-users such as pension schemes arrangements will not be able to build and maintain quantitative models to calculate IM. Instead they will use the proposed standardized schedule, which we deem to be too simplistic. Using the standardized schedule will result in end-users demanding extraordinarily high IM. Banks that have to post these margins will transfer the resulting costs to their clients. Thus, the costs of the proposed rules will be borne by the end-users.
  For many clients it will not be possible to check or verify the IM calculations done by banks.. Dispute resolutions procedures will then become ineffective and clients will be fully dependent on the banks' calculations. Disclosure to end-users of inputs, methodologies and assumptions forming a basis of the relevant calculations, is vital.

- Eligible collateral: we strongly support a very broad scope of eligible collateral.
  We note that concentration limits will increase the number of non-cash collateral trades, but implies that the same amount of non-cash available for collateral will be spread over different counterparties. If all parties use the same non-cash collateral and if all parties liquidate all received non-cash collateral at the same time (when their counterparty goes bankrupt), the same amount of notional of a certain ISIN will be liquidated.

The impact on the price drop should be more or less the same, making concentration limits not efficient as a diversification requirement.
The proposed haircuts are sufficiently conservative – except for the longer maturities on the government bonds. The haircut for maturities up to 30 years could be set at 6%. If the bond is denominated in a currency different from the base currency, an extra haircut should be applied. Proposed government bonds are not specified by the issuing countries and therefore haircuts might have to be revised.

- Treatment of provided margin: it is very important that buy-side clients will be offered the option to segregate collateral by pledging collateral through a third-party custodian of their choosing, subject to arrangements that fully protect the posting party if their counterparty goes bankrupt. We stress that this is current practice. We are opposed to a general prohibition of netting of (any form of) margin, as such would result in a severe liquidity squeeze. When contracts are 'in the money', this would simply and only result in double unused cash flows. We would rather support the approach as taken by the US SEC where the emphasis seems to be less on prohibiting netting, but more on proper segregation. We also oppose a general prohibition of re-hypothecation and re-use of IM (and VM), for pretty much the same reasons.
  Moreover, we note that if re-hypothecation of IM would be prohibited, the only remaining option for keeping IM in the form of cash and bearing interest would be to place it at an account held with a central bank, that -as we note- could even pay a negative interest. Not doing so, would result in such (IM) cash being fully unused, which is very costly and thus very detrimental to the pensioners.

- Interaction of national regimes in cross-border transactions: We stress that not only should (the risk of) duplication of margin requirements be avoided at all times, but so should the mechanism that will be put in place to safeguard them not result in case-by-case researches by and debates between authorities as to figure out which of the requirements should be applied. This will endanger current market practices which may lead to opportunity loss and thus costs.

- <u>Implementation and timing:</u> IM requirements for non-cleared OTC derivatives transactions as currently proposed are substantially higher than the IM requirements for cleared transactions, particularly where IM would not be calculated using an IM model. It will take some time for the clearing requirements to be implemented. If 'non-cleared' IM requirements would take effect prior to the mandatory clearing infrastructure being put in place, there will be *no other option than* to post the higher 'non-cleared' margin requirements until then. Similarly, if the 'non-cleared' margin requirements take effect prior to the IM models being approved, which will most likely take considerable time, the standardized schedule-alternative will have to be opted for (as opposed to the IM models), which is expected to result in higher margin requirements than IM models. A phased-in approach will thus be essential.

Please find attached as an **Annex** to this letter our specific, technical and more extensive response to the queries posed in the Consultative Document.

We hope that our response is of assistance. Should you have any questions or would you like additional clarification, please do not hesitate to contact us.

Kind regards,

Edith Maat
Head of Policy

About the Federation of the Dutch Pension Funds:
On behalf of approximately 350 pension funds, the Federation of the Dutch Pension Funds promotes the pension interests of 5.6 million participants, 2.7 million pensioners and 8.3 million early leavers.

About 85% of the total number of Dutch employees is participant of a pension fund which is associated with the Federation of the Dutch Pension Funds. The Federation of the Dutch Pension Funds is a cooperation between the umbrella organizations for industry-wide (VB), occupational (UvB) and company (OPF) pension funds.

The present response to the BCBS and IOSCO Consultative Document "Margin requirements for non-centrally-cleared derivatives" has been prepared by a joint working group of the Federation of the Dutch Pension Funds together with **APG**, **MN**, **PGGM Investment Management, SAMCo** and **Syntrus Achmea**. They are service providers of Dutch pension funds.

APG Asset Management (**APG**) is a Netherlands based asset manager for Dutch pension funds with assets under management of approximately EUR 302 billion as at May 2012. APG is itself an indirect subsidiary of Stichting Pensioenfonds ABP, the Dutch pension fund for the government and education sector and the third largest pension fund globally. APG works for more than 20,000 employers and provides for the income of more than 4.5 million Dutch citizens managing over 30% of all collective pensions in the Netherlands.

MN is a Netherlands based asset manager for a broad variety of pension funds in the Netherlands and the United Kingdom. With assets under management of approximately EUR 70 billion as per 31 December 2011, MN is one of the largest pension administrators and asset managers in the Netherlands.

PGGM Vermogensbeheer B.V. (**PGGM**) is an asset manager for Dutch pension funds in the care and welfare services based in The Netherlands, with assets under management of approximately EUR 114 billion as at 31 December 2011. PGGM Investment Management is a wholly-owned subsidiary of PGGM N.V., which is 100% owned by PGGM Coöperatie U.A., a co-operative with more than half a million members. PGGM Investment Management manages the pension assets of about 2.5 million Dutch citizens.

Shell Asset Management Company B.V. (**SAMCo**) is an asset and fund management company that provides investment advice and asset management services to pension funds associated with Royal Dutch Shell worldwide. SAMCo has approximately EUR 45 billion assets under management.

Syntrus Achmea (**SA**) is an asset manager, real estate and administration company for Dutch industry-wide, occupational and company pension funds. With approximately EUR 57 billion assets under management as per 31 December 2011, SA manages and administrates the pension of about 3.8 million Dutch citizens.

ANNEX

Specific remarks

Implementation and timing of margin requirements

- **Q1**: IM requirements for non-cleared OTC derivatives transactions as currently proposed are substantially higher than the IM requirements for cleared transactions, particularly where the IM would not be calculated using an IM model. It will take some time for the clearing requirements to be implemented. If 'non-cleared' IM requirements would take effect prior to the mandatory clearing infrastructure being in place, there will be *no other option than* to post the higher 'non-cleared' margin requirements until then. Similarly, if the 'non-cleared' margin requirements would take effect prior to the IM models being approved, which will most likely take considerable time, the standardized schedule-alternative will have to be opted for (as opposed to the IM models), which is expected to result in higher margin requirements than IM models.

  We would thus support implementation to be coordinated with both the clearing system and IM models approval timeframes. We also support a phased-in approach to enable parties to put in place the necessary arrangements. We suggest, a minimum delay of at least 180 days after the clearing rules take effect before uncleared margin rules take effect.

Element 1 (Scope of coverage - instruments subject to the requirements)

- **Q2**: We make use of FX products on a large scale. In our view, FX products should *not* be included in the scope of derivative instruments to which the margin requirements will apply. If these products will nonetheless fall within the scope of the margin requirements, at least FX contracts with a maturity of less than one year should be exempted from margin requirements.

- **Q3**: In general, initial margin requirements should not apply to (all) products and contracts existing as per the date of entering into of the new margin requirements.

Element 2 (Scope of coverage – scope of applicability)

- **Q4**: For the reasons as set out in the body of our response, we strongly request pension scheme arrangements as defined in EMIR (please see the Annex to our response for the exact definition as included in EMIR) to be exempted from IM posting requirements – whether by means of including a universal exemption, imposing an unlimited IM threshold (please see below) or excluding these entities from the definition of "financial firms".

- **Q5**: As a general remark in relation to this question, we would be in favour of implementing threshold amounts based on the types of parties and the risk they pose to the system, resulting in parties that pose no risk to the system, like pension funds not being required to post IM at all (i.e. an unlimited threshold). The thresholds should not under any circumstances be linked only to notional amounts or exposure. The rationale for implementing IM requirements is protecting counterparties from potential future exposures. Potential future exposures do not just depend on the size of notional amounts or exposure, but depend at least as much -if not even more so- on the creditworthiness of the counterparties involved.

  IM thresholds are an appropriate tool for managing the liquidity impact of the proposed requirements. The level of threshold applied to a counterparty is clear, transparent and is a more efficient way to manage margin calls and funding.

  The IM threshold should be as high as the calculated IM. Lowering the risk on a party by taking more risk on another party is not a solution. To prohibit re-hypothecation of the IM to lower the risk on this third party will incur higher opportunity costs and extra custody fees for the party posting collateral. The increase of liquidity risk and extra costs involved have a negative influence on the conduct of business for both parties. There are ways to improve the collateral business, but central clearing should not be the point of reference. The proposed portability of trades between clearing members within 48 hours seems to be hard to accomplish, causing a substantial risk on the clearing member which also requests prefunding for intraday margin calls or overnight funding.

The use of thresholds would be inconsistent with the proposed underlying goals of the margin requirements. But implementing IM requirements will lower the liquidity of a party and will therefore increase the probability of bankruptcy. If regulation for non-cleared derivatives differs from that for cleared trades, decisions based on costs and risks will be made to find the most favourable way to trade. Arbitrage occurs when the product (service) is the same. The differences between cleared and non-cleared trades are too big to speak of arbitrage. Depending on the new regulations, cross border arbitrage due to different regulations applied might cause arbitrage. But this would be an inefficient global market regulation. It will not affect our clients much, if not at all.

- **Q6**: We would generally also be in favour of implementing different thresholds, for different (types of) market participants. As stated above, we strongly request pension scheme arrangements to be fully exempted from *any* IM requirements, i.e. an unlimited IM threshold. Systemic risk contribution should most definitely be considered a primary factor when determining margin thresholds. It should serve as an indicator for the level of systemic risk posed. This can be based on ratings or on principle. Where counterparty risk and bankruptcy risk are very limited to non-existent, no IM should be put in place.

  As to *how* to determine the level of systemic risk posed, we note the following: reference to the G-SIFI list does not seem the most optimal solution considering parties listed thereon may differ from time to time, thus creating market uncertainty. Providing data on notional amounts outstanding could be a more proper approach as long as the confidentiality of market sensitive data is at all times guaranteed, but -again- not without also taking the creditworthiness of a counterparty into account as well. In general it is unclear whether the determination whether or not an entity poses systemic risk would be a one-off decision, or that the relevant data would need to be submitted on a periodical basis and such decisions would thus be taken from time to time. We note that trades should not be delayed and the administrative burden should be kept as low as possible.

Also, unlevel playing fields, even though unintended, should not be created by national regulators, because it is not fully clear for them how they have to 'translate' data received into a certain level of systemic risk contribution.

- **Q7**: The proposed treatment of PRFCs should be extended to pension schemes arrangements, since funding requirements imposed on pension plans are comparable to prudential capital requirements and pension funds must be prudently managed and diversified, although we would not be in favour of the same treatment for all PFRCs. Pension funds should not be required to post IM.

- **Q8**: No comments.

- **Q9**: As stated above, a universal two-way margin would result in OTC derivatives transactions becoming (substantially) more expensive, costs which will ultimately be borne by the pensioners. If pension scheme arrangements are made subject to IM and VM requirements, such should be two-way requirements. Pension funds are particularly sensitive to counterparty risk. However, it should ultimately be left at the discretion of the pension scheme arrangements, whether or not to actually request for a VM and/or an IM to be posted in that case.

- **Q10**: No comments.

- **Q11**: No comments.

- **Q12**: We refer to our answer to Q4 above in relation to an exemption from IM requirements for pension scheme arrangements.

Element 3 (Baseline minimum amounts and methodologies for initial and variation margin)

- **Q13**: A 10-day horizon in relation to the calculation of IM and the confidence interval is disproportionate for non-cleared derivatives transactions in terms of risks and, consequently would result in disproportionally high IM requirements. A 3-5 day liquidation period should do.

  The requirement to collect IM immediately at the outset of a transaction is unnecessary strict, operationally impracticable and thus costly – IM should not need to be collected prior to T+2 (T=date of entering into). VM should not need to be posted until T+2 (T=date of entering into) and VM calls should not be required to be made prior to T+1 (T=date of execution), all referring to local business days.

  Furthermore, we foresee many practicable issues with the proposed methodologies.

  For example:

  1. Many end-users such as pension funds will not be able to build and maintain quantitative models to calculate IM. Instead they will use the standardized schedule. This will result in end-users demanding extraordinarily high IM. Banks that have to post these margins will transfer the resulting costs to their clients. As a result, the costs of the proposed rules will be borne by the end-users.
  2. It is likely that most banks will use internal models to calculate IM. For many clients it will not be possible to check or verify these calculations. Dispute resolution procedures will therefore become ineffective and clients will be fully dependent on the banks' calculations.

  To allow the usage of internal models will lead to less transparent markets. Different banks will demand different IM for the same transaction, thus making prices no longer comparable. A possible solution would be the use of one single standard methodology to calculate IM, thus allowing end-users to calculate IM requirements and to verify banks' calculations.

This methodology should be much more sophisticated than the proposed standardized schedule. This model could for example be published by a central bank or an authorized central body. At the least: for all (internal) IM models to be approved by the local supervisors: inputs, methodologies and assumptions must be disclosed to end-users.

- **Q14**: Diversification is a key element of any investment policy. It is a well-proven concept of how managing risks that accompany investment portfolios. To neglect this key concept would be shortsighted. Relationships between asset classes should therefore be incorporated to calculate appropriate margins. The way in which these relationships are incorporated, should be conservative enough to be appropriate in times of stress..

- **Q15**: In our view the standardized schedule is too simplistic and not fit for purpose. The margin levels are not appropriately risk sensitive. For almost every derivative transaction the notional amount is not the appropriate measure for the risk it incorporates. We encourage the use of risk factors that are well known and market practice (e.g. duration). Also, we do not support the fact that netting is not allowed when using the standardized schedule. This will lead to overly conservative (and consequently too high) IM that overestimate the potential future exposure and will lead to disproportionate costs (see answer to Q13).

- **Q16**: We believe the current ISDA/CSA methodology works well. We advocate that the variation margin follows this methodology. The proposal is in line with this.

- **Q17**: We find daily payments of variation margin the most desirable option and would encourage this option. Less frequent posting could be acceptable if agreed between two parties.

- **Q18**: We see no proposals to prevent unintended procyclical effects from variation margins in this section of the document. In our view this is an omission. The VM can have an unintended but large procyclical effect.
  Our proposal is to allow for appropriate flexibility in the types of assets that are eligible for VM.

For example: a long-only investor should not be forced to post only cash as VM as this might lead to forced selling in already stressed markets. Long-only investors should therefore be allowed to post safe assets instead of cash.

The answer to the second part of the question, is “no”. The proposal states that large additional IM should be avoided, but we find no proposal on how to achieve this. Discouragement alone will be not be enough. Again, a standardized but more sophisticated model could overcome this issue.

- **Q19**: The tradeoff between operational risk/burden and counterparty risk will have to be made by each market participant on its own behalf. We believe that this cannot be stipulated by regulation.

Element 4 (Eligible collateral for margin)

- **Q20**: In general, we support a very broad scope of eligible collateral. It should be ensured that there is sufficient eligible capital available to market participants. In our view, in theory all types of assets could be used, as long as the appropriate haircuts are applied. We do, however, note that we are not in favour of using cash for IM collateral. We see several risks and practical problems in that respect, such as the fact that cash will be held on a cash account with a bank, resulting in (increased/additional) exposure to that bank. Moreover, we are not in favour of indicating gold as a highly liquid type of collateral as the valuation of gold is speculative and can be considered highly speculative in comparison to the other types of collateral that may be allowed. The credit quality of the counterparty is a very important factor that should always be taken into account.

- **Q21**: From an operational and funding perspective concentration limits will have a big impact on daily business. Concentration limits will increase the number of non-cash collateral trades, but it will imply that the same amount of non-cash available for collateral will be spread over different counterparties.

In case all parties use the same non-cash collateral and if all parties liquidate all received non-cash collateral at the same time (when their counterparty goes bankrupt), the same amount of notional of a certain ISIN will be liquidated. The impact on the price drop should be more or less the same, making concentration limits not efficient as a diversification requirement. Concerning types of specific requirements, please see above.

The proposed haircuts are sufficiently conservative, except for the longer maturities on the government bonds. The haircut for maturities up to 30 years could be set at 6%. If the bond is denominated in a currency different from the base currency, an extra haircut should be applied. Proposed government bonds are not specified by the issuing countries and therefore haircuts might have to be revised.

Commodities, equity and gold are more risk sensitive, as the maximum loss during the sample period was substantially higher than the other proposed eligible collateral. The use of commodities and gold as collateral does not have a substantial positive liquidity impact for our clients.

There are no additional assets that should be considered in the schedule of standardised haircuts, but please take the following into account:

- distinguish between base currency securities and securities denominated in other currencies; and
- distinguish between eligible currencies – exclude the majority of existing currencies and only select the most liquid currencies.

Element 5 (Treatment of provided margin)

- **Q22**: Please see our answers to Q23 and Q24 below. As a general remark, we note that in our view requirements should not be made any more specific than as currently proposed.

- **Q23**: Buy-side clients should be offered the option to segregate collateral by pledging such collateral through a third-party custodian of their choosing subject to arrangements that fully protect the posting party if their counterparty goes bankrupt. We stress that it is current practice as well. As has been rightly acknowledged in the Consultative Document, existing protection principles need to be respected.

  We are opposed to a general prohibition of netting of (any form of) margin, as this would result in a severe liquidity squeeze. When contracts are 'in the money' this would simply result in double unused cash flows and would have no other consequences. We would rather support the approach as taken by the US SEC where the emphasis seems to be less on prohibiting netting, but more on proper segregation. We point out, that in its proposed rules, the CFTC supports the benefits of portfolio margining (see CFTC Rule 22.2(d)). We also reiterate in this respect that pension scheme arrangements, are highly solvent market participants. An exemption or otherwise at least tailor made arrangements should be put in place to avoid unnecessary liquidity squeezes, to the detriment of (ultimately) the pensioners.

- **Q24**: We also oppose to a general prohibition of re-hypothecation and re-use of IM (and VM), for pretty much the same reasons as outlined under Q23 above. Moreover, we note that if re-hypothecation of IM would be prohibited, the only remaining option for keeping IM in the form of cash, interest bearing would be to place it at an account held with a central bank, that -as we note- could even pay a negative interest. Not doing so, would result in such (IM) cash being fully unused, which is very costly and thus very detrimental to the pensioners as mentioned above.

  As a general note: the Consultative Document does not provide for any proposed rules for and/or questions on the relationship between collateral margining for cleared positions and uncleared positions, for instance in case of both an interest rate derivative and an offsetting swaption being transacted, which would typically be offset – resulting in zero exposure and consequently no margin requirements.

Without permitting such offsetting trades, double margin would need to be posted –a very costly and unnecessary exercise.

Element 6 (Treatment of transactions with affiliates)

- **Q25+Q26**: We are opposed to any IM or VM requirements in case of non-centrally-cleared derivatives transactions between affiliated entities – in general, or at least if these entities are located within the same jurisdiction.

  Please note that in the Netherlands, the largest part of the pension funds' assets is managed through collective investment vehicles in which multiple (and exclusively) pension funds invest. With the ongoing consolidation in the Dutch pension industry (currently representing approximately 400 funds as opposed to 800 funds in 2009) many Dutch pension funds have , improved risk management for the purpose of professional management. To benefit from economies of scale, they have outsourced the day-to-day management of their assets to individual or joint service administration companies. These service administration companies generally are separate organizational entities, although owned/controlled by the pension funds and/or dedicated to operating solely for the benefit of those pension funds.

  Many of the said service administration companies facilitate pooling structures for pension funds in order to efficiently maximize returns from a purely operational and administrative perspective against the lowest possible costs for (ultimately) the pension beneficiaries. These asset pooling structures are not available other than within the scope of overarching individual management mandates given by the pension funds to the service administration companies and are by no means marketed nor available for parties other than pension funds.

  Within such a pension pooling structure, both the pension funds and the collective investment vehicles enter into derivatives contracts with so-called treasury entities. These treasury entities are set up for 'internal' netting purposes and operational efficiencies.

By netting their positions through a treasury entity, pension funds limit their exposure to external counterparties. The treasury entity again acts solely and exclusively in the interest of the pension funds.

<u>All of these entities fall within the scope of the definition of pension scheme arrangements, but their transactions are not likely to fall under the definition of transactions with “affiliates“.</u> If the transactions between these entities would be subject to (daily collateral exchange) requirements any benefit of using a pooled vehicle would be gone. In order to avoid a disproportionate cost impact the ‘internal’ trades of the pension funds and the collective investments vehicles with the treasury entity should also *not* be made subject to margin requirements.

Element 7 (Interaction of national regimes in cross-border transactions)

- **Q27**: We note that (i) in respect of subject matters that are left at the discretion of local regulators, we fear for the risk of regulatory arbitrage and competitive advantages for those jurisdictions having more beneficial arrangements in place and (ii) we stress that not only should (the risk of) duplication of margin requirements be avoided at all times, but also should the mechanism that will be put in place to safeguard such, not result in case-by-case researches by and debates between authorities as to figure out which of the requirements should be applied. This will endanger current market practices which may lead to opportunity loss and thus costs.

Appendix – 'pension scheme arrangements' within the meaning of EMIR

Article 2 EMIR
Definitions

(...)

(10) 'pension scheme arrangement' means:

(a) institutions for occupational retirement provision within the meaning of Article 6(a) of Directive 2003/41/EC, including any authorised entity responsible for managing such an institution and acting on its behalf as referred to in Article 2(1) of that Directive as well as any legal entity set up for the purpose of investment of such institutions, acting solely and exclusively in their interest;

(b) occupational retirement provision businesses of institutions referred to in Article 3 of Directive 2003/41/EC;

(c) occupational retirement provision businesses of life insurance undertakings covered by Directive 2002/83/EC, provided that all assets and liabilities corresponding to the business are ring-fenced, managed and organised separately from the other activities of the insurance undertaking, without any possibility of transfer;

(d) any other authorised and supervised entities, or arrangements, operating on a national basis, provided that:

(i) they are recognised under national law; and
(ii) their primary purpose is to provide retirement benefits.