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Answer to Basel Committee and IOSCO issue near-final proposal on margin requirements for non-centrally cleared derivatives

OSSIAM favourably welcomes Basel Committee and IOSCO's consultation on their near-final proposal on margin requirements for non-centrally cleared derivatives.

Ossiam is an affiliate of Natixis Global Asset Management, and manages, as of March 15th, 2013, more than 600 million euros. Headquartered in Paris, France, Ossiam is an asset management company which added value lies in the development of non-discretionary management styles, based on quantitative and fundamental analysis.

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Before providing our answers to the consultation, we would like to submit the following general remarks on the scope of coverage and applicability of margin requirements for non-centrally cleared derivatives:

- In our opinion, asset managers should not have to post and collect initial margins. Indeed, UCITS and other regulated funds are already subject to adequate risk management rules on counterparty risk exposure.
- Exemptions to the rule should not only be based on the type of instrument dealt with (as requested for FX forwards and swaps), but also on the utilization and purpose of the derivative transaction. When considering the management of a fund, a total return swap transaction involving an exchange of a basket of securities' performance to the one of an index should

also be exempted from any margin requirements. The risks entailed by these types of transactions are already covered by specific regulation.

- It would be necessary to obtain a precise definition of the term “Covered Entity” used in the consultation. This should be aligned to existing definitions under Dodd-Frank and EMIR.

Q1: Given the particular characteristics of physically-settled FX forwards and swaps, should they be exempted from initial margin requirements with variation margin required as a result of either supervisory guidance or national regulation? Should physically-settled FX forwards and swaps with different maturities be subject to different treatments?

Ossiam considers that FX forwards and swaps should be exempted from initial margin requirements regardless of their maturity.
Regarding variation margin, the current market practice is to exchange it on transactions that have a maturity exceeding three months. Therefore, and in consideration of the “Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions” document published by BCBS, variation margin should apply to FX forwards and swaps with a maturity of more than three months.

In order to avoid an unlevel playing field, rules applied should be in line with the exemptions provided under the Dodd-Frank Act. National rules on the subject should not differ from one country to another; therefore supervisory guidance should be sought for this matter. Indeed, the applicable regulatory framework should be consistent in order to avoid any regulatory arbitrage for market participants active in the foreign exchange market.

***Q2: Should re-hypothecation be allowed to finance/hedge customer positions if re-hypothecated customer assets are protected in a manner consistent with the key principle?
Specifically, should re-hypothecation be allowed under strict conditions such as (i) collateral can only be re-hypothecated to finance/hedge customer, non-proprietary position; (ii) the pledgee treats re-hypothecated collateral as customer assets; and (iii) the applicable insolvency regime allows customer first priority claim over the pledged collateral.***

In order to avoid the piling up of a multiplicity of rules for the asset management industry, re-hypothecation and re-use of collateral in the context of the exchange of margin for non-centrally cleared derivatives should align with the guidelines published by ESMA on ETFs and other UCITS issues.
Therefore, non-cash collateral received should not be sold, re-invested or pledged. Indeed, re-hypothecation of non-cash collateral creates additional counterparty credit risk since the end user may not receive the collateral back if the dealer defaults.

***Q3: Are the proposed phase-in arrangements appropriate? Do they appropriately trade off the systemic risk reduction and the incentive benefits with the liquidity, operational and transition costs associated with implementing the requirements? Are the proposed triggers and dates that provide for the phase-in of the requirements appropriately calibrated so that (i) the largest and most systemically-risky covered entities would be subject to the margining requirements at an earlier stage so as to reduce the systemic risk of non-centrally cleared Derivatives and create incentive for central clearing, and (ii) the smaller and less systemically risky covered entities would be allowed more time to implement the new requirements?
Should the phase-in arrangements apply to the exchange of variation margin, in addition to the exchange of initial margin as currently suggested? Or, given that variation margin is already a widely-adopted market practice, should variation margin be required as soon as the margin framework becomes effective (on 1 January 2015 as currently proposed) so as to remove existing gaps and reduce systemic risk? Do differences of market circumstances such as readiness of market participants and relatively small volumes of derivatives trading in emerging markets require flexibility with phase-in treatment, even for variation margin?***

The phased-in arrangements on the initial and variation margin requirements proposed in this second consultative document seem appropriate, as their implementation is gradual and after a reasonable period of time following the EMIR clearing obligations.
Regarding the implementation schedule proposed in this consultation, and as stated in the general remarks, Ossiam would like to stress out the need to obtain a clear definition of the term "covered entity". As previously indicated funds, already properly supervised and regulated, should be exempted from these margining requirements.

Q4: The BCBS and IOSCO Seek comment on the accuracy and applicability of the QIS results discussed above.

Data collected and presented in this consultative document, interesting in many aspects, are not representative of our activities as an asset manager.

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