Basel Committee on Banking Supervision
Bank for International Settlements
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Subject: Response to the Second BCBS-IOSCO Consultative Document "Margin requirements for non-centrally-cleared derivatives"

1. Introductory Statement

This response to the Second 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, PGGM, Syntrus Achmea and MN. The latter are dedicated service providers of the largest Dutch pension funds.

PGGM agrees to and follows the reaction of the Federation of Dutch Pension Funds, however PGGM would like to place extra emphasis on the following:

- We see the position of pension funds as low-risk market participants as being recognised under the rules for cleared transactions under EMIR and in the CRD IV proposal. The rules for non-cleared transactions do not take this position into account, which we believe is inconsistent;
- When considering the risks that pension funds pose, both to the system and as counterparty, a larger pension fund does not mean more risk;
- Any obligation to post IM for non-cleared transactions, as for cleared transactions, should be bilateral and not unilateral.

Please note that APG Asset Management and PGGM, two of the organisations mentioned above, have responded separately to the quantitative impact assessment (QIS) at the request of the Dutch Central Bank (*De Nederlandsche Bank*).

We appreciate the opportunity to provide comments to this second consultative document regarding margin requirements for uncleared derivatives.

Please note that the Federation of Dutch Pension Funds represents a significant portion of the defined benefit pension plans in the Netherlands that provide retirement benefits for more than 80 per cent of Dutch workers.

Pension funds exist solely to provide retirement income security. Pursuant to the European IORP Directive they are allowed to use derivatives for risk management

and efficient portfolio management purposes only. Unlike other market participants pension funds do not use derivatives to take risks for commercial purposes.

2. General remarks

- The QIS results show that the working group has primarily asked the banking sector to provide input. By doing so, the effects of the margin requirements on the buy side, especially for the pension fund sector may not sufficiently be on the radar of the working group members. The impact of those margin requirements on pension funds and other buy-side parties will be huge and may even affect pension funds' opportunities to hedge interest rate and currency risk. The overview of the QIS results does not properly address the (few) responses that have been provided by insurance companies / pension funds. We note that two of our members, both exclusively managing pension fund assets, have participated in the QIS. The figures presented by them showed a massive impact on, ultimately, the pensioners. Buy-side market participants such as pension plans will not only be made subject to punitive and very costly margin requirements, but they will also be the parties that will have to bear the indirect market costs of the introduction of margin requirements. Dealers will pass on the cost they have to make for their uncleared business to pension funds and to other buy-side parties, effectively meaning that the buy side and particularly the pension funds will have to pay for the introduction of margin requirements for uncleared derivatives transactions. The consultative document does not reflect this impact at all. We are worried that, as a consequence thereof, this adverse impact will not form part of the further debates on margin requirements for non-cleared derivatives.

- We note that the working group consists predominantly of banking regulators and banking experts, which may also explain why the risk profile of pension funds has not been sufficiently addressed or taken into account. Although we agree with the principle of two-way margining, we feel that the working group's proposals should also recognize the very low counterparty credit risk that pension plans pose. Pension plans are now treated the same way as more commercial and less risk-averse entities active in the derivatives markets.

- We remind the reader that within a risk-based approach it would be inconsistent to subject pension plans to margin requirements in the same way as other more commercial and less risk-averse market participants. Pension plans and their use of derivatives transactions should not be viewed as posing systemic risk. On the contrary, they should be viewed as reducing such risk, because they are stable counterparties on the financial markets. Within a risk-based approach pension plans should not be seen as covered entities given that they create little or no systemic risk. They are currently seen by dealers as low-risk counterparties that do not pose material default risk. By not taking into account the risk profile of pension funds, the working group opts for a one-size-fits-all approach which is not what the G-20 or the EU legislators aimed at.

- We appreciate and fully support the acknowledgement that the margin requirements should not apply to any and all market parties, as well as that it will require an appropriate period for implementation. We do believe however that notional amounts of transactions should not be -or should not be the only- drivers for granting such exemptions. Notional amounts do not *per se* equal a certain level of systemic risk contribution. Creditworthiness and the risk profile of counterparties is a far more appropriate method of establishing systemic risk contribution. Any phase-in thresholds should therefore be adjusted to reflect the risk posed by a counterparty. The threshold for the notional amount of uncleared derivatives should be much higher for pension funds using derivatives to hedge their risks. We note that corporates that use derivatives for hedging purposes are excluded from the initial margin requirement. In our view this should apply equally to the hedging transactions of pension funds.

Concerning the specific questions in the consultative document we have the following remarks:

Element 1: Scope of coverage - instruments subject to the requirements

Q1:

- We believe that physically settled FX forwards and swaps should not be made subject to margin requirements. Physically settled FX forwards and swaps do not have a relevant risk impact. This should in any case apply to FX forwards and swaps with a short duration of, for instance, < 1 year. With short maturities, the risk contribution -if at all any- would also only be short-term. These products pose less risk than other derivatives and these risks are already mitigated by global settlement systems, use of which could be made obligatory. Also, replacement risk is very limited as a result of the highly liquid nature of the currency markets. Finally, FX forwards and swaps are used by a great number and variety of parties -among which pension funds and corporates- to hedge risks and discouraging their use could result in higher levels of systemic risk.

Element 5: Treatment of provided initial margin

Q2:

- We most strongly support allowing for re-hypothecation. If re-hypothecation would not be allowed, the issue of liquidity / availability of collateral would be doubled, if not quadrupled.

- Cash is not ideal for IM, because of the opportunity loss associated with the posting of cash. Pension funds generally do not have a lot of cash available. Also, a danger of using cash is that we would be depositing such cash as IM with commercial banks. Depending on local regulation and lacking proper ring-fencing, cash deposited with a commercial bank would cause us to suffer losses in case the bank defaults.

Element 8: Phase-in of requirements

Q3:

- We appreciate and fully support the acknowledgement that the margin requirements should not apply to any and all market parties, as well as that they will require an appropriate phase-in period. We do believe that notional amounts of transactions should not be -or should not be the only- drivers for granting such exemptions. Notional amounts do not *per se* equal a certain level of systemic risk contribution. Creditworthiness and the use of risk profiles are far more appropriate methods for establishing systemic risk contribution.

- The phasing-in of requirements defines a notional amount which determines whether two parties have to exchange IM. This notional amount becomes smaller and is set at 8 billion euro from 2019. From paragraphs 8.4. to 8.7. it is stipulated that IM should only be exchanged if both parties have more than the notional amount of non-centrally cleared derivatives, but in paragraph 8.8. this last requirement (as long as it meets that condition) is lacking. Does this then mean that parties remaining below the 8 billion threshold will receive IM from 2019 on but will no longer have to deposit?

- We think that the obligation for the Variation Margin (VM) should be introduced by January 1st, 2015.

Appendix C 9: Initial margin requirements and unencumbered assets

Q4:

- The QIS was lacking in detail and depth and concentrated almost exclusively on the effects on banks. In relation to the QIS and its results, we note that apparently out of the 39 respondents, 33 were banks. The lack of detail and depth of the QIS means that its results should not in any case be used to base long-term policy on that will have a large impact on billions of people. We feel that the QIS does not give a proper overview of the impact for the entire relevant market because the impact on banks will be quite different from the impact on insurance companies and pension funds. For instance, banks will typically be able to use their own internal models while insurance companies and pension funds typically may not. As we have stressed in our earlier responses, the use of the standardized margin model will result in substantially higher margin requirements – which has also been recognized in the consultative document. The overview of QIS results does not properly address the (few) responses that have been issued by insurance companies / pension funds. We note that two of our members, both managers of pension fund assets, have participated in the QIS and the figures they presented showed a massive impact on, ultimately, the pensioners. The consultative document unfortunately does not reflect this. We are worried that, as a consequence thereof, this adverse impact will not form part of the further debates on margin requirements for non-cleared derivatives.

We strongly advise to undertake a second QIS focussing on the effects on long-term investors such as pension funds.

We are ready to provide further technical input and expertise and ask to take our remarks and concerns into account.

Kind regards,
PGGM

About PGGM:

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 130 billion as at 31 December 2012. PGGM 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 manages the pension assets of about 2.5 million Dutch citizens.