

EFAMA's Comments on CPSS-IOSCO's Consultative Report on Principles for Financial Market Infrastructures

EFAMA is the representative association for the European investment management industry. It represents through its 26 member associations and 56 corporate members approximately EUR 13.5 trillion in assets under management, of which EUR 8 trillion was managed by approximately 53,000 funds at the end of 2010. Just under 36,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds.

EFAMA welcomes the possibility to comment on the CPSS-IOSCO consultative report, and overall strongly supports its proposals.

EFAMA believes **it is essential that the standards for Financial Market Infrastructures (FMIs) take into account the interests of the final investors/holders of the securities**, who may not be direct users of the infrastructures or direct participants due to the use of intermediaries. **Equal protection of all stakeholders is crucial because of the monopolistic or oligopolistic nature of the infrastructures, and to increasing regulation mandating their use** in more areas, for example through the obligation to centrally clear derivative contracts (introduced by the EMIR Regulation in the European Union and by Dodd-Frank in the US). Protection of final investors/indirect users is above all necessary because of the commercial nature of most FMIs.

EFAMA fully agrees that safety is a primary policy objective for FMIs, and that FMI risks should be robustly managed, particularly in view of the systemic nature of FMIs and their contribution to financial stability. However, for some FMIs – Central Counterparties for example – safety requirements should not preclude a consideration of the impact on different market participants in light of mandatory clearing requirements. Please see our comments in this regard on Principles 5 and 6.

We strongly support the Report's proposals on segregation and portability, but we believe that provisions for portability in a non-defaulting scenario deserve more prominence.

EFAMA supports internationally accepted principles for FMIs and their consistent application on a global level. Conflicting regulation should be avoided, particularly for derivatives regulation, including extraterritorial provisions that effectively impose multiple requirements on market participants.

EFAMA supports the governance requirements in the Consultative Report, and is grateful for the detailed level of the provisions. However, we regret that representation for indirect users/participants is not foreseen. Investment managers will not be direct users/participants in FMIs, but will nonetheless have a fiduciary duty to protect the financial interests of their clients, and assets under their management will also be at risk.

Detailed Comments

Principle 1: Legal basis

EFAMA fully supports Principle 1 and the Key Considerations, particularly No. 2. In that regard, we wish to stress that segregation provisions and service offerings from FMIs must be consistent with regulation for investment management, so as to avoid legal conflicts and to allow investment managers to fulfill their obligations towards their clients. Please see also our comments on Principle 14.

Principle 2: Governance

We welcome the acknowledgment that indirect participants are relevant stakeholders for FMIs, whose objectives should be supported. Our members will not access clearing houses directly but will have much at stake as users (in terms of positions and margin), and therefore great interest in fair treatment and participation in FMI governance. With the introduction of mandatory central clearing for derivatives, indirect user membership in CCP Boards and, in particular, in risk committees will be very important. Boards and committee composition should not be dominated by clearing members or CCP representatives, but independent members cannot be necessarily expected to represent indirect users' interests, therefore indirect users should have representatives with voting power.

Principles 4 and 7: Credit and Liquidity Risk

For Central Counterparties, additional clarity on the additional financial resources that should be maintained and on the types of liquid assets that will be held by the FMI are recommended. They would be helpful and important for investment managers in their due diligence to choose FMIs.

Principles 5 and 6: Collateral and Margin

EFAMA members broadly agree with the principles for margin and collateral for central clearing.

From a financial stability perspective, we agree that collateral should have low credit, liquidity and market risk. However, collateral and margin requirements should also consider the impact on different market participants.

Investment managers manage funds and portfolios that invest in a variety of assets, and to achieve the best return for the clients they have to be fully invested according to investment guidelines. They therefore do not dispose of large amounts of cash to post collateral to fund margins on large, directional positions, and they have been able to use a variety of assets to post collateral for OTC contracts.

CCPs nowadays typically require cash collateral, particularly for variation margin purposes. To post cash collateral, investment managers would be obliged to liquidate a significant portion of the portfolios/funds, thus losing the returns on those assets. The amounts of cash needed – and the related costs/loss of income – would be high, particularly for portfolios for pension funds or insurance companies using LDI strategies to hedge long term liabilities, although also retail funds would be negatively impacted.

However, the requirement to post cash collateral is largely due to the operational setup of CCPs, and – particularly with regard to initial margin – we believe it would be feasible to find technical solutions to enable indirect participants to post margin using a wider choice of assets, with appropriate haircuts and without compromising the safety of the CCPs.

Such concerns should be taken into consideration so that low-risk institutional investors who were not responsible for the financial crisis – and indirectly pensioners and savers – do not bear a disproportionate cost for central clearing infrastructure.

Principle 14: Segregation and Portability

Collateral protection is a top priority for investment managers, in view of their fiduciary duty towards their clients and particularly as a result of the Lehman bankruptcy, and we see this Principle as crucial in providing a global high-level standard of protection.

EFAMA fully agrees with the key considerations on segregation and portability in the Report. In particular, full transparency on CCP's rules, policies and procedures is essential in the light of different insolvency regimes.

The CCP must provide the option for indirect participants to choose full segregation (not just segregation in a client omnibus account), if desired to individual mandate or fund level. A requirement to segregate the assets of individual funds or mandates may be imposed by regulation in some jurisdictions¹, or could be required by institutional clients of the investment manager.

¹ Such option could be particularly important for investment managers managing contractual-type funds, where the fund has no separate legal personality and the counterparty to the derivatives contract is always the manager, for all funds.

We also agree with the importance of portability – both in case of default but also in a non-defaulting scenario. Portability upon request (according to footnote 97) should be more prominent and included in the body of the CCP rules because indirect participants need to have the commercial freedom to transfer their positions and collateral from one clearing member to another. Such flexibility could be needed by investment managers to meet their duties towards their underlying clients, for example to manage the counterparty risk towards the clearing member.

We hope our comments have been of assistance and remain at your disposal for any clarification you may require.

Peter De Proft
Director General

29 July 2011

11-4056