



## Alternative Investment Management Association

CPSS & IOSCO Secretariats

Submitted by email to:

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24 June 2010

Dear Sirs,

**CPSS-IOSCO consultative reports:**

- Guidance on the application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC derivatives CCPs (the 'CCP Recommendations') and
- Considerations for trade repositories in OTC derivatives markets (the 'Trade Repository Considerations') (together, the 'Consultations')

The Alternative Investment Management Association (AIMA)<sup>1</sup> is pleased to have the opportunity to respond to these consultations on creating guidance as to the application of the 2004 CPSS-IOSCO Recommendations for central counterparties (CCPs) to over-the-counter (OTC) derivatives CCPs and a report on considerations for the establishment of trade repositories.

AIMA fully supports the work of CPSS-IOSCO in creating international high-level standards for the creation of an efficient centrally cleared OTC derivatives market that focuses on financial stability and transparency to address issues identified during the financial crisis of 2008 and the ongoing market instability. As significant users of OTC derivatives for investment and hedging purposes, AIMA's hedge fund manager members are particularly interested to ensure that reforms and regulations are well thought out, coordinated and consider the impact for all market participants.

We therefore make the following general observations on the topics covered in the consultation.

**The CCP Recommendations**

AIMA overall supports the political, regulatory and industry steps taken to encourage a move from bilateral clearing of OTC derivatives trades to clearing on robust CCPs, where there is regulated minimum exchange of collateral to manage credit exposures, financial resources to deal with defaulting clearing members, clear and transparent governance arrangements and transparency surrounding costs and the contracts being entered into. Whilst AIMA supports the greater use of exchange trading where possible, we recognise that there remains a need for an OTC derivatives market that allows market participants to enter into bespoke contracts to hedge specific risks. We are therefore pleased that CPSS and IOSCO also recognise this need and are, with these CCP Recommendations, encouraging CCP clearing of privately negotiated contracts.

We are also pleased that the CCP Recommendations provide useful guidance as to the general considerations for CCPs in deciding whether a contract is 'eligible' to be cleared. This implies that certain contracts are not eligible to be cleared, because of certain unmanageable risks for CCPs, highlighted by the considerations. AIMA encourages CCPs to clear as many contracts as they are able to but recognises that certain contracts will not be eligible to be cleared in this way. These contracts, we believe, should be required to be subject to tough

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<sup>1</sup> AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector - including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,100 corporate bodies in over 40 countries.

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collateral and margin requirements, to cover counterparties' credit exposures, but should not be removed from the market altogether at the expense of parties' inability to hedge their risks. For the reasons identified in the CCP Recommendations, AIMA believes that CCP clearing should, where possible, be encouraged to "reduce the risks and uncertainties faced by market participants and contribute to the goal of financial stability".

As buy-side firms in the derivatives market, AIMA's manager members have most direct concerns in the following areas:

### *Participation*

AIMA's member firms range in size and many of the larger fund managers have considered the benefits of direct access to OTC derivatives CCPs. AIMA is pleased to see that CPSS-IOSCO supports fair and open access to CCPs, based on objective, publicly disclosed criteria, including as to financial resources, operational capacity and necessary expertise. We are also pleased that it is recognised that potential direct participants may be structured (in terms of business and financial resources) differently from traditional clearing members (i.e. banks) but that, provided any additional risks are taken into consideration, such non-traditional clearing members are still eligible to participate. It is important that those interested in participating are not discriminated against by the traditionally bank dominated clearing members, as additional clearing members only strengthen CCPs and contribute to their success.

### *Segregation and portability of collateral and positions*

As the main purpose of central clearing is to encourage financial stability, AIMA's members believe it is essential for them to retain confidence that their collateral will only be used to cover their own positions and, accordingly, real segregation is required, to allow client margin not to be subsumed within the insolvent estates of clearing members - and either returned or transferred to another CCP clearing member ('portability') to continue the contract. As the CCP Recommendations recognise, applicable insolvency law should be amended, if necessary, to "permit the identification and separate treatment of customer and proprietary assets".

Clients of clearing members should have the option as to the level of segregation necessary for them; CCPs should be required to provide a range of segregation options, from full segregation in individually named custodial accounts with third parties to holding of client assets in omnibus accounts, each at reasonable commercial cost. In any case, we support the CCP Recommendations which provide for clearly stated policies, procedures and constraints (legal, operational or otherwise) relating to segregation, sufficient information being given to clearing members and their clients on the segregation achieved and transferring of segregated positions and collateral to other solvent clearing members.

### *Representation of interested parties (including buy-side firms)*

If buy-side firms choose to become direct clearing members of CCPs, they will be entitled to a 'say' with other clearing members about how the CCP is run and the business the CCP accepts. However, it is important to acknowledge that the buy-side naturally makes up half of the industry, so that it should have a proportionate ability to contribute to the decisions of the CCPs it used, regardless of whether buy-side firms are clearing members. This is most important in the context of CCP risk committees, which in the currently operating CCP firms have been established to make decisions about risk factors relevant to the clearing members, clients and the contracts being cleared, as identified in the CCP Recommendations.

We are aware that, whilst nearly all buy-side firms are in favour of the greater use of CCPs in the OTC derivatives markets, many of the largest dealer banks are less in favour because CCP clearing creates additional costs for them in allocating financial resources to the CCP and does not, in some cases, generate the same level of returns as bilateral clearing. It is, therefore, important that buy-side firms have a real voice on risk committees and governance boards of CCPs, to put across their views. We would therefore encourage the CCP Recommendations to go further than 'due consideration' to ensure buy-side firms' views are given real and

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proper consideration. This may be in the form of allowing them to become elected members of risk committees, but should not be merely a right to be consulted on decisions.

### *Competition and the global market*

Whilst AIMA's manager members' primary concern is the establishment of workable clearing house solutions, as the market develops we would be in favour of a healthy market that sees CCPs compete on the levels of services they provide but not on the highest risks they will accept. We therefore support the transparency requirements in Recommendation 14, which would require CCPs to disclose the risks that they identify in their operations, the methods with which those risks are managed and the fee structures applicable for clearing services. Only by requiring such disclosure can a competitive market develop.

It is also important to recognise that the OTC derivatives market is global and that, where parties in different jurisdictions are entering into OTC trades, they may wish to use a CCP in either party's jurisdiction or a third jurisdiction, depending on various factors. We note that CPSS-IOSCO recognise the international nature of the market but we stress that market participants will want to use alternative CCPs in situations other than simply where "no feasible domestic alternative exists".

To this end, it is important that the regulation of CCPs, market participants and OTC derivative contracts is coordinated as much as possible across global markets - it is in this area that we feel the CPSS-IOSCO guidelines provide the greatest value for markets. The CCP Recommendations should therefore be high-level, to allow flexibility yet provide sufficient clarity as to what is expected of those who follow the Recommendations. We believe that CPSS-IOSCO have achieved this goal in the CCP Recommendations.

### *Trade Repository Considerations*

The establishment of trade repositories to report on the open and settled positions in the OTC derivatives market is an important element of the reforms to that market, and AIMA approves of the various aspects recommended for relevant authorities to consider when establishing such repositories.

We feel that the biggest requirement addressed by the establishment of trade repositories is to provide a central storage of market data for relevant authorities to access, to make the decisions concerning the regulation of individual market participants and decisions on how best to prevent market instability. For these reasons, relevant authorities will need good quality firm-specific data that meets what they assess to be their needs. AIMA believes that transparency in this regard will assist in making clear the state of the market current at any time and will allow those authorities to make better, more informed rule-making and regulatory decisions. The need for public access to repositories is also important as this provides important market information to help valuation of sometimes difficult to value OTC derivatives contracts during the life of the contract and at settlement; it would be equally important to value positions in the event of a clearing member's default.

We agree with CPSS-IOSCO's statements encouraging sufficiently standardised, good quality and reliable data that is disclosed in a timely and proper manner and meets the needs of the users of that data. One element we feel is important for the buy-side participants in the market is that it should be clear with whom the reporting obligation rests - we believe that it is most efficient for that to be the clearing member who enters trades in the course of its business and can establish systems to report all trades in a standardised way. To provide maximum value to all users of data, processes should be put in place to consolidate similar data between competing trade repositories in different jurisdictions or asset classes.

Due consideration of how the trade repositories will operate is important for relevant authorities considering how to regulate their operations and AIMA's primary concern in this regard is that data is held securely. Much of the data given to the trade repositories would indicate highly sensitive, proprietary trading strategies of managers, and whilst we do not object to relevant authorities having that information, it would be damaging to our members' businesses if the information were ever to be lost, leaked or accessed by inappropriate and unauthorised parties. As such data indicates trading strategies and other proprietary data, the information may

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also be considered 'confidential'; relevant authorities should ensure that they address possible conflicts of law and other legal barriers to access.

AIMA has no strong opinion on whether there are a number of trade repositories set up in certain jurisdictions or whether they are run instead like public utilities and operate one per jurisdiction or one per asset class. However, it is important that they are well managed, reliable in terms of access and disclose 'reasonable' fees for the services they provide.

### Conclusion

AIMA supports the CCP Recommendations and the Trade Repositories Considerations and encourages CPSS-IOSCO to finalise each of the documents and promote these to Basel and IOSCO member countries. Both provide valuable contributions to reaching international agreement on the important reforms to the OTC derivatives market which will, over time, help improve market stability and guard against future financial crises.

We hope that the matters raised in our response are of assistance in the consultation process. We understand that there will be no further reports but it is intended that the guidance presented in the reports and feedback from the consultation will be incorporated in the general review of the international standards for financial market infrastructures, launched by the CPSS and the Technical Committee of IOSCO in February this year. However, if there are points on which you wish to have further clarification, please let me know.

Yours faithfully,

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