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by email:
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CCP-OTC-Recommendations@iosco.org

**Comments on the CPSS/IOSCO consultation on policy guidance for
central counterparties in the OTC derivatives market**

Dear Mr. Tanzer,

in response to the above mentioned consultation, please find below BVI's¹
views on the subject at hand.

We are pleased to have the opportunity to comment the suggested policy
guidance for central counterparties (CCP) in the OTC derivatives market.

We are supportive of the CPSS/IOSCO policy guidance for central
counterparties in the OTC derivatives market.

We would like to make the following comments:

General remarks:

A robust risk management system for the CCP is vital to protect both its
clearing and non-clearing members. Of particular importance are margin and
collateral management, as well as pricing and default procedures.

Implementation of CCPs with the buy side needs careful planning and
should not to be rushed. All market participants need sufficient time to

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¹ BVI Bundesverband Investment and Asset Management e.V. represents the interest of
the German investment fund and asset management industry. Its 85 members currently
manage assets in excess of EUR 1.7 trillion both in mutual funds and mandates for
some 16 million investors. For more information, please visit www.bvi.de.

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prepare. Our members need 6 to 12 months to set up policies and procedures for using a CCP following resolution of the major legal and operational issues.

It should also be considered that any discretion left with the CCP to decide what contract or instrument type it can clear might require a participant to use several CCPs in order to clear all transactions or even worse clear them outside a CCP. This would increase the costs and the operational risks. Further, this would reduce the possibility of cross-margining.

CCP clearing and the obligation to clear eligible contracts must be aligned with existing and up-coming EU legislation applicable to market participants, e.g. UCITS management companies and alternative investment fund managers.

The CCP provider should act as a service provider to the industry. Proper rules on data governance are of utmost importance for the proper functioning of a CCP. Reference to MiFID (para 15) is not sufficient. The work of a CCP needs to be based on open data standards, especially ISO standards for the identification of parties, instruments and accounts as well as ISO messaging standards (ISO20022). Identification of eligible contracts should be based on the ISIN (ISO6166). The identical method chosen by CESR within TREM should be considered as an interim solution until sufficient derivative contracts are created by ISO standards. Without prescribing the use of open standards interoperability between CCPs will not be possible.

The CCP should not be able to claim any intellectual property rights for the industry-delivered data on cleared contracts. There should be no license requirements or fees for the use of the data made available by the CCP in internal systems of market participants, including client and regulatory reporting.

Specific comments

Recommendation 1: Legal risk

Decisions regarding contract standardization must involve representatives of the buy-side and be subject to meaningful public consultation. Industry expert groups/consultative bodies at Commission level should be involved in



the process. Standardization of terms and conditions shall not be based exclusively on ISDA agreements. Master agreements used by a significant number of market participants such as the German Master Agreement (“*Deutscher Rahmenvertrag*”) shall be acceptable too. Standardization of “Events”/“Definitions” may be based on ISDA Definitions. Market participants have reasons to agree on different types of documentation. For example, the 2005 ISDA Commodity Definitions do not include commodities index derivatives while such instruments are covered by the German document (“Annex for Rohwarengeschäfte”).

The terms and conditions applicable to all Clearing Members (CM) of the CCP should not restrict to a specific Master Agreement. Otherwise, this would restrict the possibility of the CCP to connect with other CCPs who have decided for a different Master Agreement.

Recommendation 2: Participation requirements

Guidance 2.1: Participation requirements for non-regulated entities

We support the idea of participation requirements for both regulated and non-regulated entities. However, we would like to mention that investment fund management companies as part of the buy-side are always regulated entities (based on the UCITS- directive and the German investment act).

The implementation of additional CCP-requirements for non-regulated entities should not be accompanied with increased cost for the buy-side compared to the cost of regulated direct participant of a CCP. Otherwise, there is a risk that non-regulated entities use bilateral agreements which is not in line with the aim of the regulation to clear more OTC-trades through a central counterparty.

We know that our members are not able to meet the participation requirements for a clearing membership as long as the operational and legal barriers to a buy-side access of a CCP are not solved.

Most of our members will use OTC derivatives CCP only on the basis of indirect membership as it is currently the case for listed derivative products.

Our members may prefer a similar give up/take up structure for CCP clearing of the OTC derivatives as is used for listed derivative products. This

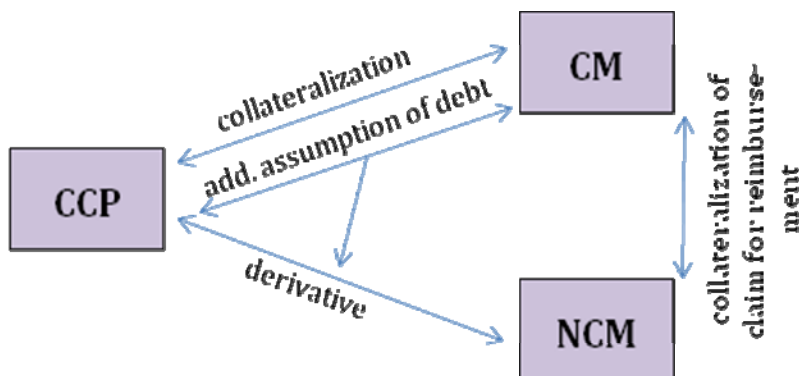
structure simplifies the transfer of open positions/margins between client CCP participants, i.e. from a defaulting clearing member to a non defaulting clearing member. A cross netting between OTC-trades and listed derivative products mitigates the risk for the buy-side as whole.

We support the idea of an alternative model which could be used in parallel to the above mentioned give up/take up structure for users in the investment fund industry.

The CCP might offer also participation for non-clearing members with requirements which can be met by most market participants, including investment fund management companies and investment funds.

The fulfillment of the contractual obligations arising from an OTC derivative by a non-clearing member could be guaranteed by a clearing member. The non-clearing member should be obliged to provide the clearing member with sufficient collateral in order that the clearing member is able to fully collateralize the claim of the CCP with respect to the guaranteed OTC contract.

An overview of the model:



The main benefit would be a direct access by a non Clearing Member to the CCP without the need to use a Clearing member in full. This may lead to benefit in terms of cost and efficiency.



Recommendation 4: Margin requirements

The margin requirements should be calculated on an individual basis for a single OTC-transaction. A portfolio margining by a CCP should only be done across the same products. Portfolio margining across different products should be avoided.

Recommendation 6: Default procedures

- **CCP-defaults**

There should be clear provisions of how a CCP default is dealt with. In particular in respect of any open transaction, the margin already transferred to the defaulting CCP and the fees charged by another CCP to which any transaction might be transferred. Further, clear guidelines should be put in place if a transfer to another CCP is not possible because the other CCPs are not authorised to clear certain contracts.

It should be possible for an investment manager to change the clearing member through which it accesses CCP facilities. A non-clearing member should therefore be able to request a transfer of open positions from one clearing member to another, or to a member of a different CCP. Interoperability in some form between CCPs must be pursued after the start-up phase is over.

- **Clearing-Member defaults**

BVI believes that it is essential to have account segregation for client/buy-side collateral and positions for the clearing member in order to reap the benefits of CCP clearing.

Incentives or regulation covering CCPs and/or clearing members must be introduced to ensure that segregation is either introduced at CCP level, or available at clearing member level. The segregation at CCP level needs to be clarified in the various insolvency laws concerning CCP's and CM's. Furthermore, the obligations of a CM client in case of a default of a CM should be limited to the margins paid to the CM.



In case of a default of a direct participant the transfer of the positions (as well margins) should occur without delay to another clearing member. The transfer should take place automatically based on standard instructions and procedures.

A general liability of a clearing participant beyond the agreed margins and capital fund guarantees for the default of another clearing member (“waterfall”) should be avoided as it increases the risk of another CM-default. Participants cannot influence other market participants at the CCP and are not able to ask those other participants for additional collateral.

Recommendation 13: Governance

BVI supports strongly the representation of interested parties in the governance of a CCP. The interests of buy-side users such as investment firms, UCITS management companies and alternative investment fund managers must be adequately reflected in the CCP’s governance rules and structures as required by Guidance 13.1.

Buy-side representation on the Board of CCPs is needed to ensure fair treatment of all users, in view of the dominant position of the few CCPs and of possible conflicts of interest deriving from CCP ownership by large financial institutions.

Recommendation 14: Transparency

Transparency to the public of CCP governance rules, risk management, segregation arrangements and prices is key to permit due diligence by investment managers. MiFID does not guarantee such disclosure, as the execution policy of an intermediary used as a clearing member would not cover clearing arrangements. Clearing members are not obliged to disclose in advance either the CCPs used, or the associated cost.

Given the often monopolistic nature of a CCP it is not sufficient to regulate only the minimum capital of a CCP or the transparency of prices and fees. User fees should be primarily based on the clearing service delivered and the risk incurred. We believe that if the CCP provider cannot demonstrate that the total revenue across all clients on a like-for-like basis is only increasing by either (a) inflation (RPI) or similar, or (b) an adjustment to



reflect an expansion in transaction coverage, then the EBA/governing body should not approve the CCP pricing schedule.

We hope you will find our comments helpful. Our response can be made public.

With kind regards

BVI Bundesverband Investment und Asset Management e.V.

(signed)
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Managing Director

(signed)
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