Investment Management Association

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Committee on Payment and Settlement Systems and
Technical Committee of the International Organisation of Securities Commissions

Bank for International Settlements and IOSCO
c/o BIS
Communications
CH-4002 Basel
Switzerland

27 July 2011

Dear Sirs,

Principles for financial market infrastructures - consultative report

The Investment Management Association (IMA) represents the asset management industry in the UK. Our members include independent fund managers, the investment arms of life insurers and banks, and managers of occupational pension schemes. Altogether they manage some €4 trillion of assets, with substantial holdings across Europe and globally.

The IMA's role is to represent the interests of the industry to government and regulators both in the UK and internationally, and to promote high standards within the industry. Many of our policy positions are set out in responses to consultations.

We believe it is essential that the voice of investment managers is heard in European regulatory debates. This is because those firms manage assets on behalf of clients such as pension and life funds, authorised investment funds, pooled investment vehicles and private client accounts – in other words, on behalf of ordinary savers and investors across Europe.

Thank you for the opportunity to respond to this consultative report. We have some general comments, largely focused on the new regulatory landscape in central clearing.

Generally, we are pleased that IOSCO and BIS have chosen to consult on principles for financial market infrastructures (FMIs). FMIs have always been of fundamental importance to the efficient functioning of financial markets, and are likely to become even more so once the current wave of legislative change is enacted. Clear principles guiding their operation are therefore essential.

We are pleased that IOSCO recognises that, despite their commercial ownership, FMIs should explicitly support the objectives of financial stability and acknowledge the public interest element of their service. This is important in the context of current regulatory change which is proving to be extensive. It is equally important in relation to the application of competition law principles, since many FMIs operate monopoly or near-monopoly services. This should not be read as a criticism, merely an observation that financial market infrastructures can and frequently do operate with concentrated service provision.

As an example, if a significant portion of the OTC derivatives market is mandated to go into central clearing, in the US, EU and in many other jurisdictions, clearing houses will become systemically important. It would be imprudent in regard to proper market operations if these institutions were not to have to consider more than their own commercial objectives. Conversely, we are somewhat surprised that the paper does not address in detail the need to have resolution regimes applicable to FMIs that are deemed to be of systemic importance. A great deal of work has been conducted across different jurisdictions on crisis management for banks (principally) and we believe this should be extended to FMIs as well – although not necessarily in the same form.

We are pleased that governance is addressed in the paper in some detail. Specifically, section 3.2.1 acknowledges that indirect participants will be key stakeholders in FMIs - their views should therefore be sought actively. For example, our members will not access clearing houses directly but, as they will be mandated into central clearing by regulation, they – not the intermediaries – will own much of the margin held in the system. How they interact with the CCPs will matter a great deal. This will be particularly important in the work of CCP risk committees, where we have argued for direct client membership. If this does not happen, it is likely that clearing members will dominate in a way that may put clients at a disadvantage. The paper helpfully acknowledges the importance of the risk management function governance.

Still on the subject of clearing, we agree with the principles for margining and collateral. From a financial stability perspective, it is hard to argue against the need to keep collateral liquid and avoid pro-cyclicality.

We would, however, point out that the understandable desire to keep CCPs safe should not preclude a consideration of how these requirements will impact different market participants in light of mandatory clearing requirements. Markets are not binary structures operating between FMIs and their immediate members (banks). All participants have an interest and to ignore the client side is to turn a blind eye to how a market ticks - and what can keep it safe. Arrangements that have worked well between banks and clearing houses should not be assumed to work in the same way when clients are pulled directly into the clearing ambit.

For example, our members, who are long-term investment managers, would not usually hold sufficient free cash to fund margins on large, directional, positions

entered into for their clients such as pension funds. Instead, these clients are usually invested in more productive assets. Typically they have instead posted alternative types of high quality collateral, with a haircut where necessary. We dispute the version of events that suggests that clients should raise cash through their banks in order to fund positions mandated into clearing. This brings large additional cost to the clients, but more importantly also complicates the process quite unnecessarily given that high quality assets are available to collateralise their positions. We believe there should be proper consideration of this.

We fully agree with the key considerations on segregation and portability. In particular, full transparency on CCP's rules, policies and procedures is essential in the light of disparate legal regimes across different jurisdictions. It is precisely because of those differences that principles such as these are needed – they provide a high-level standard to be achieved despite the different insolvency regimes.

We also agree with the importance awarded to portability – but believe the non-defaulting scenario, as noted in footnote 97, should be more prominent and included in the CCP rules. This is because clients should have commercial freedom to transfer their positions and collateral from one clearing member to another, and this should be addressed and facilitated in legislation and CCP rules. Otherwise, mandatory provisions on clearing become even more anti-competitive, in that they act to prevent normal commercial relations.

Finally, we are pleased that the paper places emphasis on internationally-accepted principles for FMIs and their consistent application. It has become a truism that financial markets are global and that local rules will only lead to regulatory arbitrage. But we see time and time again regulators developing and implementing rules unilaterally, or including extraterritorial provisions that effectively impose double (or multiple) requirements on market participants. This must be avoided, and principles such as these constitute the first step for international cooperation. This has to be followed by a more detailed consideration in specific areas.

If you have any questions, please do not hesitate to contact us.

Yours faithfully,

Jane Lowe
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