ASSOGESTIONI
associazione del risparmio gestito

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ASSOGESTIONI'S COMMENTS ON CONSULTATION PAPER ON DRAFT REGULATORY TECHNICAL STANDARDS ON RISK MITIGATION TECHNIQUES FOR OTC DERIVATIVE CONTRACTS NOT CLEARED BY A CCP

Assogestioni[1] would like to thank the ESAs for the opportunity to contribute to the discussion on some key aspects of the drafting of the RTS on risk mitigation techniques for the OTC derivative contracts not cleared by a CCP.

With regards to the current consultation, before answering the specific questions raised in the document, we would like to highlight some elements that we think the ESAs should take into consideration.

Overview

In general we understand the overall aim of the regulation to increase the resilience of financial markets in the belief that the financial community and the economy as a whole would benefit from a system that allows a better monitoring and management of risks. We also believe it to be essential that the measures adopted should be proportional to actual risks posed by the various actors and products – which should be differentiated taking into account their size, their role in the financial market and the regulation that already controls their behavior.

We are glad that the ESAs have decide to take into account these elements by introducing a number of thresholds both to reduce the scope of the obligation to post initial margins so to target only counterparties with large exposure to derivative risks and to introduce the possibility to negotiate bilaterally the opting out from the exchange of the initial margin. We also appreciate that the ESAs are excluding FX forwards and swaps from mandatory initial margination. There are nevertheless some general aspects of the current proposal that Assogestioni believes deserve clarification.

[1] Assogestioni is the Italian asset management association representing almost 300 management companies and € 1.4 bn in AUM.

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Scope of application: while Assogestioni appreciates the specific reference to investment funds in recital 5, it would be useful to confirm that the provision applies also to pension funds.

Threshold: we believe that to fully benefit from the exemption and in order not to burden smaller players carrying no relevant risk to the system, it would be advisable to design the threshold in reverse: the scope should be defined in positive so as to make it mandatory for counterparties with an average notional amount of non centrally cleared derivatives higher than the identifies threshold to exchange initial margins.

Two-way margination: the concept of two-way margination should be further clarified to avoid doubts on whether a counterparty which is below threshold would still have to comply and post margin in case its counterparty is above threshold. Should the two-way margin concept cause the attraction of the counterparty with lower exposure into the margination obligation and considering the nature of most derivative contracts, where at least one of the counterparty is a large investment bank, the majority of players – regardless of their own exposure to derivatives- would have to carry the burden of complying with the initial margination requirements.

Post capital or hold assets: complying with the cover rule (Art. 51 para. 3 of Directive 2009/65/EC) should be recognized as equivalent to holding own capital. According to Recital 3, a counterparty shall have the choice either to post/collect (initial) margins or holding own capital if the amount of initial margin is below the threshold. As investment funds are subject to the cover rule, they are only allowed to enter into derivatives which can be fulfilled with the assets of the investment fund. In order to avoid any misinterpretation, the ESAs should clarify in Recital 3 that in case of investment funds, complying with the cover rule is an equivalent to holding own capital.

Definition of new contracts : in order to avoid ambiguities at the time of entry into force of the RTS and as regards the application of the regulation only to new contracts (Recital 18), we would like authorities to confirm that the modification in amount due to the unwinding of an existing position – i.e. the gradual reduction in exposure leading to the closure of the position – is not to be considered as a new contract and hence would be exempt from the application of the regulation. This in virtue of the fact that all elements remain the same –counterparties, type of contract, closing date - the only change being in the value of the exposure that is in fact being reduced.

Management of collaterals and ESMA Guidelines: besides the issues related to the scope of the RTS and with reference to the rules on the management of collaterals, in our view, the existing UCITS regulation for the use of collateral implementing at national level the ESMA guidelines for issues related to ETFs and other UCITS[2i] offers sufficient guarantees for a safe and efficient management of collateral and should be extended also to the rules on collateral under EMIR. The extension of banking

[2] ESMA Guidelines on ETFs and othre UCITS issues (ESMA/2012/832)

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regulation regarding collateral management to all types of counterparties would unnecessarily burden asset managers while existing UCITS diversification regulation would sufficiently protect the investors assets without unduly constraining the use of assets and the discretionality of the asset managers.

Reply to questions in the consultation

Question 1. What costs will the proposed collateral requirement create for small or medium-sized entities, particular types of counterparties and particular jurisdictions? Is it possible to quantify these costs? How could the costs be reduced without compromising the objective of sound risk management and keeping with the proposal aligned with interaction standards?

The implementation of RTS is expected to be rather costly both in terms of administrative costs generated by the revision of existing contracts with counterparties and with outsourcers.

In addition, relevant IT costs will have to be incurred by all counterparties in order to be able to fully incorporate collateral management into their procedures. These costs are only in part proportional to the value of the derivatives used and hence affect disproportionally smaller entities.

In particular, as discussed above, the application of banking regulation to the collateral managements without regards to the specificities of other types of players and products and already existing regulation would be detrimental to an efficient and effective collateral management.

Limiting the scope of the obligations and allowing for an efficient and flexible management of collaterals will minimize costs without affecting the benefits in terms of risk reduction.

Question 2. Are there particular aspects, for instance of an operational nature, that are not addressed in an appropriate manner? If yes, please provide the rationale for the concerns and potential solutions.

In general, we believe that the regulation drafted here is better suited for the banking sector while the guidelines produced by ESMA regarding collateral management is better suited for UCITS. In particular a number of operational issues would make it inefficient and costly for UCITS to manage collateral without further lowering risk and increasing the pressure on cash at system level.

In particular, although we appreciate the possibility foreseen in the draft of using shares of UCITS as collateral, from a technical point of view it appears difficult to implement as a number of technical issues; in particular, as of today, an integrated European settlement circuits for UCITS does not exist and prompt transfer between counterparties located in different countries is practically impossible.

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In general we expect growing pressure on liquidity, due to increased demand for cash stemming from mandatory bilateral collateralization, mandatory clearing via CCP for standard derivatives, counterparties preference for collateral posted in cash.

Question 3. Does the proposal adequately address the risks and concerns of the counterparties to derivative in cover pools or should the requirement be further tightened? Are the requirement, such as the use of CRR instead of a UCITS definition of covered bonds, necessary ones to address the risks adequately? Is the market-based solution as outlined in the cost-benefit analysis section, e.g. where a third party would post the collateral on covered bonds which for not meet the conditions mentioned in the standards?

No observations.

Question 4. In respect of the use of a counterparty IRB model, are the counterparties confident that they will be able to access sufficient information to ensure appropriate transparency and to allow them to demonstrate adequate understanding to their supervisory authority?

In our view, we expect the sharing of information and the monitoring of internal rating model to be of difficult implementation as it would mean - at least to a certain extent - requiring/granting the counterparty access to internal evaluation and methodology. We expect as the most likely scenario, the emergence of third parties models which can be adopted and agreed upon by both counterparties.

Question 5: How would the introduction of concentration limits impact the management of collateral (please provide if possible quantitative information)? Are there arguments for exempting specific securities from concentration limits and how could negative effects be mitigated?
What are the pros and cons of exempting securities issued by the governments or central banks of the same jurisdiction? Should proportionality requirements be introduced, if yes, how should these be calibrated to prevent liquidation issues under stressed market conditions?

As already discussed, Assogestioni believes ESMA guidelines to be a more appropriate regulation since the regulation proposed in this current draft appear to be excessively detailed not allowing counterparties to assess what is needed to cover the risk. The current proposal focuses excessively on the quantity and the proportion of the various components of the guarantee while placing its quality and liquidity in second place: in fact, imposing the proposed concentration limits would mean to mechanically constrain the use of good quality collateral in favour of a diversification that would raise costs and complexity while not necessarily reducing risk. We strongly support the exemption of government and central bank bonds from the concentration limits as well as the introduction of a threshold for the margin below which concentration margin should not apply. Imposing diversification on relatively low amount i.e. margin just above the 50 mil € threshold, would require complex and unnecessary splitting of the collateral into excessively small subsets of assets.

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Question 6. How will market participants be able to ensure the fulfilment of all the conditions for the reuse of initial margins as required in the BCBS-IOSCO framework? Can the respondents identify which companies in the EU would require reuse or re-hypothecation of collateral as an essential component of their business models?

We believe that the rules for reuse of initial margins identified in BCBS –IOSCO regulation offer sufficient guarantees for counterparties posting margin and we do not think that re-use and re-hypothecation should be banned altogether.

While thanking the authorities for giving us the opportunity to contribute to the debate, we remain at your disposal for any further discussion.

Yours sincerely,

The Director General

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