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COMMENT LETTER

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ICI Global Submits Comment Letter in Response to IOSCO's Proposed Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives (pdf)

October 16, 2014 Ken Hui International Organization of Securities Commissions (IOSCO) Calle Oquendo 12 28006 Madrid Spain Re: Public Comment on Consultation Report on Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives Dear Mr. Hui: ICI Global1 appreciates the opportunity to provide comments on the consultation report issued by the International Organization of Securities Commissions ("IOSCO") emerging from the IOSCO Working Group on Risk Mitigation Standards for Non-centrally Cleared Over-the-counter ("OTC") Derivatives.2 The Consultation Report represents IOSCO's initial policy proposals that would establish risk mitigation standards for non-centrally cleared OTC derivatives. Our members – US funds that are regulated under the Investment Company Act of 1940 ("ICA") and similar non-US regulated funds publicly offered to investors, such as UCITS (collectively, "Regulated Funds") – use non-centrally cleared OTC derivatives in a variety of ways. Derivatives, including non-centrally cleared OTC derivatives, are a particularly useful portfolio management tool in that they offer Regulated Funds considerable flexibility in structuring their investment portfolios. Uses of swaps and other derivatives include, for example, hedging positions, equitizing cash that a Regulated Fund cannot immediately invest in direct equity holdings, managing a Regulated Fund's cash positions 1 The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$18.7 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC. 2 Consultation Report, Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives (September 2014), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD450.pdf ("Consultation Report"). ICI Global Letter to IOSCO October 16, 2014 Page 2 of 5 more generally, adjusting the duration of a Regulated Fund's portfolio, or managing a Regulated Fund's portfolio in accordance with the investment objectives stated in a Regulated Fund's prospectus. To employ non-centrally cleared OTC derivatives in the best interests of fund investors, our members have a strong interest in ensuring that the derivatives markets are highly competitive and transparent. ICI Global members, as market participants representing millions of investors, generally support the goal of providing greater oversight of the

derivatives markets. The Consultation Report includes nine standards for risk mitigation techniques (“Standards”) including key considerations that describe how the Standards should be implemented.3 According to IOSCO, risk mitigation techniques for non-centrally cleared OTC derivatives would have three main benefits: (1) promoting legal certainty and facilitating timely dispute resolution; (2) facilitating the management of counterparty credit risk and other risks; and (3) increasing overall financial stability. We generally agree that the risk mitigation techniques described in the Consultation Report could help reduce risks to counterparties engaged in OTC derivatives transactions, the OTC derivatives markets, and the financial markets more generally. We note that the U.S. Commodity Futures Trading Commission (“CFTC”) and the European regulatory authorities have already adopted risk mitigation rules broadly consistent with the proposed Standards. Although we welcome efforts to harmonize these rules on global basis, we believe that international coordination of regulatory standards is most effective when they are developed prior to jurisdictions adopting their final rules in a particular area. In addition, given the time and effort market participants have spent on implementing the rules prescribed by the CFTC and the European regulatory authorities, we would welcome IOSCO encouraging the CFTC and the European Commission to confirm that neither jurisdiction would need to alter their respective rules as a consequence of the Standards. With respect to the Standards proposed by IOSCO, we recognize that IOSCO has a difficult task of drafting Standards that are sufficiently specific to ensure consistent application of risk mitigation techniques across jurisdictions while providing local regulators the flexibility to accommodate the unique characteristics of their markets. We believe IOSCO’s approach generally provides the right balance between these two key objectives. We recommend, however, that IOSCO give further consideration to implementation, cross-border, and certain other issues. We discuss these concerns in more detail below. IOSCO Should Provide More Guidance on How Jurisdictions Should Apply Their Risk Mitigation Standards Where Duplicative or Conflicting Rules Could Apply Given that many non-centrally cleared OTC derivatives transactions are conducted across multiple jurisdictions, ICI Global supports efforts for real and meaningful coordination among regulators on how the Standards will be applied to market participants that engage in cross-border 3 The Consultation Paper also includes explanatory notes further elaborating on the Standards and the key considerations and their rationale. ICI Global Letter to IOSCO October 16, 2014 Page 3 of 5 transactions. In the Consultation Report, Standard 9 provides that "[t]he different regulatory regimes should interact so as to minimize inconsistencies in risk mitigation techniques for non-centrally cleared OTC derivatives across jurisdictions." We support the Standard as a laudable goal because cross-border transactions give rise to the risk of the application of duplicative or conflicting rules by authorities that may exert jurisdiction over the transaction. We do not believe, however, that the approach taken in Standard 9 goes far enough in removing the uncertainty regarding whether a cross-border transaction will be subject to the laws of more than one jurisdiction. If there is not sufficient guidance provided to national regulators, regulators may take differing approaches to how they will regulate cross-border transactions and may impose duplicative and/or conflicting requirements. In fact, this concern is being manifested in the context of the margin requirements for non- centrally cleared derivatives as regulators in the United States are proposing divergent approaches to the cross-border application of the margin requirements. Although we supported adoption of international standards for margin requirements for non-centrally cleared OTC derivatives by the Basel Committee on Banking Supervision (“BCBS”) and IOSCO, we warned that regulatory coordination will be complex and that the proposed framework did not adequately address numerous questions on how margin requirements would apply to cross-border transactions.4 We recommended that the BCBS and IOSCO develop a more detailed framework for how margin requirements will apply to transactions conducted across

borders. Because BCBS/IOSCO's final margin policy framework ultimately did not contain sufficient detail regarding what triggers the laws of a particular jurisdiction and which law would apply (and to which aspects of the transaction) when the laws of more than one jurisdiction could apply to a transaction, different U.S. regulators are now proposing different approaches regarding how they would apply their margin rules to cross-border transactions.5 We believe this potential divergence in approaches in this critical area is an unfortunate development particularly because so much effort has been expended to developing the international standards. We, therefore, urge IOSCO to provide more detailed guidance on how the rules of different jurisdictions on risk mitigation techniques would apply to cross-border transactions. One alternative would be to include in Standard 9 a requirement that, in situations in which more than one regulatory 4 Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Wayne Byres, Secretary General, Basel Committee on Banking Supervision, Bank for International Settlements, and David Wright, Secretary General, International Organization of Securities Commissions, dated March 14, 2013, available at http://www.ici.org/pdf/27111.pdf; Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Wayne Byres, Secretary General, Basel Committee on Banking Supervision, Bank for International Settlements, and David Wright, Secretary General, International Organization of Securities Commissions, dated September 27, 2012, available at http://www.ici.org/pdf/26529.pdf. 5 See Margin and Capital Requirements for Covered Swap Entities, 79 FR 57348 (Sept. 24, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf (prudential regulators proposing one approach to cross-border transactions); Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 FR 59898 (Oct. 3, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-10-03/pdf/2014-22962.pdf (CFTC proposing three alternatives to cross-border transactions). ICI Global Letter to IOSCO October 16, 2014 Page 4 of 5 regime may apply, the parties to that transaction could elect or agree between themselves the regime with which they will comply. Another option would be to provide specific guidance on how substituted guidance or equivalence should operate in situations in which the regulations of more than one jurisdiction could apply. IOSCO Should Adopt Implementation Periods that Are Practicable and Not Disruptive to Derivative Markets We note that Standard 8 provides that "[a]uthorities should implement the standards described in the paper as soon as possible." The Standard further suggests that authorities should consider the feasibility of implementing the risk mitigation standards around 1 December 2015 (the date on which the BCBS and IOSCO recommended that the margin requirements for the non-centrally cleared OTC derivatives should become effective). We are concerned that this proposed schedule does not provide sufficient time for an orderly implementation of the Standards. Compliance with the requirements prescribed by the Standards will involve a significant investment of time and resources by relevant participants. For example, systems to ensure timely confirmation, portfolio reconciliation and portfolio compression will need to be acquired or developed, tailored to the relevant market participant's particular circumstances, and thoroughly tested. There also will need to be numerous changes to trading documentation to reflect the Standards. These changes may need to be implemented by bilateral amendment of documentation where circumstances do not permit use of protocols or similar multi-party amendment. We are concerned that regulators often underestimate the time necessary to build the appropriate systems infrastructure and to amend documentation to reflect changes in regulatory requirements. To ensure an orderly implementation of the Standards, we recommend that IOSCO expressly recognize that the timetable for implementation should reflect the technological and practical challenges to which market participants will be subject. Although we appreciate IOSCO's objective of introducing the Standards as soon as possible, we urge

IOSCO to adopt compliance dates that would not cause unnecessary disruptions to the markets. Obligations Prescribed under the Standards Should Apply to Market Participants Best Equipped to Implement such Obligations We note that the Standards would apply to financial entities and systemically important non- financial entities. We believe that it would be appropriate to impose the responsibility for carrying out those risk mitigation techniques on entities that engage in a certain level of activity. As noted by IOSCO, dealers play a central role in the non-centrally cleared OTC derivatives market. We believe authorities could achieve broad application of the Standards by imposing the obligations in respect of risk mitigation techniques on dealers rather than on both counterparties. Dealers also may be better equipped and have more resources than other market participants to develop systems to comply with the Standards. * * * ICI Global Letter to IOSCO October 16, 2014 Page 5 of 5 We appreciate the opportunity to respond to the Consultation Report. If you have any questions on our comment letter, please feel free to contact the undersigned, Susan Olson at +1-202- 326-5813, Sarah Bessin at +1-202-326-5835, or Jennifer Choi at +1-202-326-5876. Sincerely, /s/ Dan Waters Managing Director ICI Global +44-203-009-3101
