



For the attn. of:

Mr Olivier Guersent, Director General for Financial Services policy, DG FISMA
European Commission

Mr Steven Maijoor, Chair
European Securities and Markets Authority

Mr Andrea Enria, Chair
European Banking Authority

Mr Gabriel Bernardino, Chair
European Insurance and Occupational Pensions Authority

Via electronic transmission

Brussels, 7 February 2017

Dear Sirs,

Unchartered Legal Situation - Concerns about the Variation Margin (“VM”) Compliance Date for Pension and Regulated Funds (UCITs, AIFs and US Regulated Funds).

The associations signing this letter (“We”) are writing to you to request respectfully a creative and legally binding change of the compliance date for variation margin requirements in the regulatory technical standards (“RTS”) of risk mitigation tools for non-centrally cleared OTC derivatives under the European Market Infrastructure Regulation (“EMIR”).

According to our current information, the vast majority of market participants (many of them being buy-side firms) will not have the required documentation for their OTC derivatives transactions in place prior to the imposed time-frame.

Given the volume of documentation that still must be completed despite good faith efforts by regulated funds, we strongly **recommend that the European Securities Markets Authority (“ESMA”), the European Banking Authority, and the European Insurance and Occupational Pensions Authority (collectively, “ESAs”) and the European Commission work to implement a delay of at least six months**

of the current compliance date of 1 March 2017 through a dedicated Regulated Technical Standard, as already implemented in several non-European jurisdictions¹. This will allow funds and their counterparties to complete the documentation that complies with the new requirements and make reasonable and continuous progress towards fully implementing the variation margin rules.

Alternatively, if the RTS cannot be executed in due time because of the complexities of the EU legislative process, we ask the European Commission to request that ESMA work with National Competent Authorities and provide forbearance on the enforcement of the variation margin requirements for at least six months.

While an RTS is adopted to delay the compliance date, our Associations would welcome a “no-action relief” communication that would inform the market participants of the absence of pursuit by the ESMA or any National Competent Authority for a defined period of time. Alternatively such relief of action could be applied on some categories of market participants such as pension funds, and categories 3 and 4 market participants, in line with the proposed regime for centrally cleared transactions.

Detailed Comments

Despite significant efforts of regulated funds and asset managers to comply with the variation margin requirements by March 1, many of our affected members are struggling to ensure that proper documentation is in place before that date, due to factors outside their control. As further described below, these challenges include:

- The late communication of the final rules and the short time period currently available for implementation;
- The volume of derivatives agreements that funds have to enter into or amend;
- Counterparties setting priorities on contractual reviews due to the limited time and resources available at legal and operation levels;
- The absence of satisfactory protocols for non-bank derivatives market participants; and
- The time and cost involved in obtaining legal opinions on the enforceability of a netting arrangement in different jurisdictions.

¹ Australia, Hong Kong, and Singapore all have announced their implementation timetables. Each jurisdiction has included a 6-month transitional period for VM implementation, beginning on March 1, 2017, and ending on August 31, 2017. CFTC Acting Chairman Giancarlo recently noted that “As Acting Chairman, I also intend to look at solutions to ease the March 1st transition in a responsible manner. Look for the CFTC to have more to say about this in the weeks to come.” Keynote Address of CFTC Commissioner J. Christopher Giancarlo Before SEFCON VII (January 18, 2017), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-19>.

The consequences are that:

- Our counterparts are alarmingly planning to stop trading new derivatives transactions if they do not have executed documentation, de facto blocking funds from hedging of new transactions; and
- Our members, which are all active worldwide, are afraid of the possible repercussion that would be triggered by the difference in rules in different countries.

From our perspective, the above proves the material difficulties in complying with the new rules, which leads us to request a “no-action relief” communication. This approach would have multiple benefits as it would:

- reassure all market participants;
- reduce implementation costs by avoiding to recruit or externalise the negotiation at higher costs; and
- preserve existing transactions, that would be dragged in the new regime in case of events such as a “partial unwind”.

This also would facilitate the international alignment of the implementation of G20 requirements by getting closer to the approach taken recently in many non-EU countries (e.g. Singapore, Hong Kong, and Australia).

I. The New Collateral Obligations Present Significant Documentation Challenges for Regulated Funds.

To comply with the new rules, regulated funds must negotiate and execute documentation that complies with the new requirements. Funds that have existing documentation generally must amend those documents to comply with the new requirements. Until very recently, our members, however, have had difficulty even obtaining information regarding how these documents could be amended, mainly because the dealers were focused on various impending deadlines – margin requirements among dealers in September 2016 in the United States and the clearing obligation ²in the European Union in December 2016.

Moreover, many members with existing documentation have had to negotiate bilaterally with their dealers to retain the important terms that regulated funds had negotiated previously with their dealer counterparties. As a result, amending existing documentation began later than registered funds expected and has taken a significant period of time.

² See Commission Delegated Regulation (EU) 2015/2205 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation (setting forth clearing compliance dates for interest rate swaps in major currencies), available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R2205&from=EN>.

II. Regulated Funds Have Made Significant Effort to Comply with the New Requirements Despite Numerous Obstacles.

Regulated funds have undertaken considerable efforts to comply with the new requirements reaching out to their dealer counterparties to enter into new agreements or to update their current agreements. Unfortunately, because of the time constraints, it appears that many dealers have been prioritizing their clients, which means that smaller funds or funds with smaller derivatives exposure have received the least amount of attention from their counterparties.

Although this approach may make sense for dealers from a commercial perspective, smaller regulated funds have been disadvantaged, and these funds and their shareholders will be harmed disproportionately if they are not able to trade swaps starting from March 1. We are not suggesting relief targeted at smaller funds, since the problem is much broader; we are just highlighting a particularly acute aspect of the problem.

Moreover, the New CSA method – one of the methods for complying with the new requirements and the method that regulated funds without existing CSAs would likely utilise - was just finalised on 26 January.

Until recently, the VM Protocol's New CSA option did not include provisions necessary to accommodate segregation of variation margin at a third-party custodian.

Therefore, regulated funds as a practical matter could not use this method.

In addition, because the terms were just finalized, it is not likely that the supplements to the New CSA method will be available on ISDA's electronic platform before 1 March 2017. Therefore, funds and their counterparties will have to negotiate the agreements in a more labor intensive manner.

Furthermore, we are concerned that, if the compliance date is not delayed, regulated funds would be forced to accept terms in their agreements that are far less favorable just to be able to continue trading swaps after 1 March.

Finally, members have had to search for solutions to satisfy the requirement to perform an independent legal review of the legal enforceability of the bilateral netting arrangement in each jurisdiction. Finding a cost-effective means to comply with that requirement has been quite difficult for members, and alternatives are only starting to become available.

III. US and European Regulators Should Coordinate an Extension to Remove the Potential for Regulatory Arbitrage.

We urge the ESAs and the National Competent Authorities to implement a delay, particularly if US regulators delay their compliance date, to avoid

- worldwide regulatory arbitrage; and

- global fragmentation of the derivatives markets.

To prevent this outcome, we recommend that the ESAs and the Commission coordinate with US regulators to align the deadline of implementation and the enforcement of the variation margin regime.

We are confident that our proposed extension strikes a proper balance between the requirements set by the regulators and the needs of the investment fund industry to adequately document those crucial contracts.

Yours faithfully,

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