For the attn. of:

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

Mr. Patrick Pearson
European Commission

Mr Toomas Vapper
European Council

Mr. Roberto Gualtieri MEP
Mr. Werner Langen MEP
European Parliament

17-1085 3 October 2017

Dear Sir, dear Madam,

Re: Request for Deferral and Reconsideration of Uncleared Swap Variation Margin (“VM”) Requirements for Physically-Settled Foreign Exchange Derivative Contracts (“FX Contracts”)

Beginning in January 2018, EU investors subject to the European Market Infrastructure Regulation (“EMIR”) will face application of Variation Margin (“VM”) requirements for FX forwards¹, the only remaining type of FX Contract without VM requirements available for hedging EU clients’ FX risk.

¹ Article 37 of the European Supervisory Authorities’ (the “ESAs”) Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP derogates the application date VM obligations for FX forwards until the date of entry into application of the Commission Delegated Regulation (2016) 2398, which specify some technical elements related to the definition of financial instruments. See Commission Delegated Regulation (EU) 2016/2251 of 4 October 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty (the “RTS”).
Although Article 27 of the RTS finalized under EMIR (see footnote 1) excludes initial margin ("IM") for FX Contracts, it does not provide a parallel exclusion for VM.

The undersigned Associations wish to express their concern regarding aspects of the application of the RTS that are forcing the collateralisation of FX Contracts. In particular, the signatories to this letter are concerned that a requirement to exchange VM for FX Contracts for counterparties such as fund management companies will:

- undermine funds and their asset managers’ ability to hedge risks, increasing underlying risk levels;
- undermine pension funds’ use of derivative contracts for risk management purposes. Pension funds use derivatives to manage their risks in their balance sheet by hedging – among others – their currency risks. The IORP Directive explicitly allows pension funds to use derivatives for mitigating investment risks or and for efficient portfolio management.
- prevent such counterparties from being able to use FX Contracts on a cost-efficient basis, or indeed at all.

Therefore, we ask the ESAs to request to the Commission the authorisation to review the currently proposed text and to act quickly in seeking deferral of the upcoming VM requirements that will be imposed upon FX forwards, the only remaining FX Contracts over which VM does not yet apply in the EU.

We further request that the above-listed authorities reconsider whether the EU’s VM requirements for FX Contracts are needed for regulatory or systemic objectives. FX Contracts are crucial to the management of currency mismatches in investment strategies when an investor’s home currency is different from the currency of the portfolio’s investments.

As raised previously by the undersigned\(^2\) and as has been demonstrated by the path taken in other major jurisdictions, the Associations believe that a more principled, risk-based approach to collateral for FX Contracts achieves the best balance of regulatory objectives against the costs ultimately borne by pension funds, regulated funds (UCITS and AIFs) and other investors served by asset managers. Further, for many smaller U.S. advisers whose clients do not generally trade derivatives but that occasionally use FX Contracts to hedge currency risk (e.g., in long-only equity strategies) the new VM requirements will be unduly burdensome. Since FX Contracts are not typically in-scope for uncleared swap margin requirements in the United States, these advisers do not have not infrastructure in place to exchange margin (e.g., ISDAs, CSAs, and other processes).

In contrast to the EU, investors subject to the laws of other major jurisdictions do not face similar prescriptive VM requirements for FX Contracts. Authorities in Switzerland, the U.S., Canada, and a number of Asia-Pacific jurisdictions have taken a risk-based supervisory approach, excluding FX Contracts from their uncleared swap margin rules in favor of the 2013 Basel Committee on Banking Supervision’s ("BCBS") supervisory guidance.\(^3\)

---


If, however, VM must be exchanged due to EU law applying, EU clients and their asset managers are left to decide whether the client’s interests are best served by accepting the negative consequences or leaving the currency risk unhedged. This decision is more acute for smaller clients for whom the costs are proportionally larger. In addition, if the client is not in the EU, the client or its asset manager may decide that the client’s interests are best served by restricting trading to non-EU banks to avoid automatic VM that EU banks must impose under EMIR.

Deferral of these requirements until further review can be undertaken is needed urgently. Much work remains to implement these requirements, especially for investors who engage in no other products requiring VM under the RTS. While we have been raising this issue for some time, we believe the practical differences and consequences between the EU standards for FX contracts and the other major jurisdictions have only recently come into focus. As such, a deferral of application beyond January 2018 is needed to allow careful consideration of the impact upon investors in the EU subject to the requirements, and the broader impact on a cross-border basis.

Consequently, the Associations ask that:

(1) the ESAs request a deferral of the VM requirements for FX forwards sufficiently beyond January 2018 so that the above-listed authorities can reconsider the EU’s approach;

(2) the ESAs in combination with the European Commission and National Authorities implement a deferral; and

(3) the authorities reconsider the VM requirements for FX Contracts via the EMIR Refit or other legislative processes.

In making this request, we recognize the procedural difficulties of deferral in the EU; however, if the authorities believe, as the Associations do, that investors and pension beneficiaries’ interests are best served by delaying this requirement, we hope that a procedural path can be found to achieve this result.

Should you have any questions, please contact the undersigned.

Respectfully submitted,

Peter De Proft  
EFAMA  
Director General  
Peter.deproft@efama.org  
+32 2 513.39.69

Monique S. Botkin  
Investment Adviser Association  
Associate General Counsel  
monique.botkin@investmentadviser.org  
+1 202 293 4222

Jennifer S. Choi  
Investment Company Institute  
Associate General Counsel  
Jennifer.Choi@ici.org  
+ 1 202 326 5876

Matti Leppälä  
PensionsEurope  
Secretary General  
Matti.leppala@pensionseurope.eu  
+ 32 2 289 14 14

Laura Martin  
SIFMA Asset Management Group,  
Managing Director and  
Associate General Counsel  
LMartin@sifma.org  
+ 1 212 313 1176
* * *

The European Fund and Asset Management Association (EFAMA) is the representative association for the European investment management industry. EFAMA represents through its 28 member associations and 61 corporate members close to EUR 23 trillion in assets under management of which EUR 14.1 trillion managed by 58,400 investment funds at end 2016. Just over 30,600 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 27,800 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit www.efama.org

The Investment Adviser Association (“IAA”) is a not-for-profit association that represents the interests of investment adviser firms that are registered with the U.S. Securities and Exchange Commission (SEC). Founded in 1937, the IAA’s membership consists of over 640 firms that collectively manage more than $20 trillion in assets for a wide variety of individual and institutional investors, including pension plans, trusts, registered investment companies (RICs or mutual funds), private funds, endowments, foundations, and corporations. For more information, please visit the IAA website: www.investmentadviser.org.

ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI’s membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$27.2 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

The Asset Management Group of the Securities Industry and Financial Markets Association (“AMG”) brings the asset management community together to provide views on policy matters and to create industry best practices. AMG’s members represent U.S. and multinational asset management firms whose combined global assets under management exceed $39 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

PensionsEurope represents national associations of pension funds and similar institutions for workplace pensions. Some members operate purely individual pension schemes. PensionsEurope Members are large institutional investors representing the buy-side on the financial markets. PensionsEurope member organisations cover different types of workplace pensions for over 110 million people. Through its Member Associations PensionsEurope represents more than € 4 trillion of assets managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.