



Alternative Investment Management Association

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002
Basel
Switzerland

By email: fsb@bis.org

28 November 2013

Dear Sirs,

AIMA Response to FSB Paper ‘Strengthening Oversight and Regulation of Shadow Banking - Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos’

The Alternative Investment Management Association¹ (AIMA) welcomes the opportunity to respond to the Financial Stability Board’s (FSB) proposed regulatory framework for haircuts on non-centrally cleared securities financing transactions (the Proposals) contained in ‘Strengthening Oversight and Regulation of Shadow Banking - Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos’ (the Policy Document).²

The below describes AIMA’s position with reference to the Proposals. We have not responded to each of the questions in the Proposals individually, as we believe it would be clearer to describe our position more generally to the FSB.

AIMA acknowledges the importance of building a regulatory framework that seeks to limit procyclical margin calls. However, we do not believe that the establishment of numerical haircut floors is likely to reduce procyclicality meaningfully, given the absence of comprehensive data that could be used to calibrate numerical floors. At the same time, the introduction of numerical floors could impact negatively on the ability of hedge fund managers to negotiate appropriate haircuts on a contractual basis.

As such, we believe that the FSB should attach greater weight to the tools which are already available to market participants in the assessment of counterparty eligibility, either before or during contractual negotiations. These tools in many cases negate the need for the sort of additional regulatory provisions envisaged in the FSB paper. In particular, we refer to the general assessment of counterparty credit risk that market participants undertake in the early stages of a counterparty relationship; if a potential counterparty is deemed not to be sufficiently creditworthy, a market participant is at liberty to refuse to contract with such entity. If the creditworthiness is sub-optimal, a market participant may request that the counterparty’s obligations are collateralised accordingly.

If, however, the FSB does ultimately decide to recommend a framework of numerical floors on haircuts, we believe that the framework should apply to “regulated intermediaries” as defined in section 4.1 of the Proposals; a framework that applies only to situations in which an entity not subject to regulation of capital and liquidity/maturity transformation receives financing from a regulated intermediary will inevitably harm competition, potentially leading to regulatory arbitrage.

Finally, we encourage the FSB to consider the fact that any policy measures in respect of shadow banking need to take into account global credit contraction and reduced overall market liquidity, as well as the potential impact on the availability of unencumbered assets. Measures that are not properly calibrated could have a harmful impact on the functioning of securities financing markets, with harmful consequences for economic activity.

¹ As the global hedge fund association, the Alternative Investment Management Association has over 1,300 corporate members (with over 7,000 individual contacts) worldwide, based in over 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors.

² Available at: http://www.financialstabilityboard.org/publications/r_130829b.pdf

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Minimum Standards for methodologies used by market participants to calculate haircuts

AIMA believes that any minimum standards should be implemented in a globally consistent manner to reflect the global nature of the repo markets and prevent regulatory arbitrage based on location. In practice, this means that national and regional rules should be put in place in a synchronised manner, with a high degree of convergence in terms of the substance of those rules.

The Proposals set out a list of relevant factors that should be included in minimum standards for methodologies used by market participants to calculate haircuts. Generally, we support the establishment of a framework that requires market participants to address specific factors in their methodologies for calculating haircuts, as long as those factors are described in high-level terms, and as long as individual firms are able to use those factors in a way that is appropriate for their own models. This is important given the extensive range of instruments utilised in the repo and securities lending markets and the associated need to create a framework that is able to accommodate the differences between such instruments.

Accordingly, as long as the list of factors can be applied by individual firms in a way that reflects their own business models, then we believe that there are additional factors that could be addressed, including:

- the length of the repo/financing transaction; and
- the counterparty credit risk associated with the transaction.

Numerical floors on haircuts

Generally speaking, AIMA maintains that the introduction of numerical haircut floors is unnecessary, especially given the disclosure proposals outlined in policy recommendations 1, 2, 3, 4 and 5 contained in the Policy Document. Further, we believe that the introduction of numerical floors would erode the ability of managers to negotiate haircuts on a contractual basis. This could result in a loss of manager bargaining power when they negotiate their securities financing agreement and a reduction in the flexibility of market participants to determine credit risk at an appropriate level with reference to the particular counterparty.

If numerical haircut floors are to be implemented, AIMA believes they should apply to all qualifying transactions between all types of counterparties, so that all market participants are equally subject to these floors. In other words, the scope of the application of the Proposals should cover situations in which a regulated intermediary receives financing. This will ensure that the Proposals do not give rise to competitive distortions between different categories of market participants. Similarly, sovereign bonds should not be exempt from numerical floors since such instruments are subject to default risk and thus can have procyclical risk premia, with leverage in the financial system building up against sovereign bond collateral.

Phase-in period for implementation of the policy recommendations

We believe that it is appropriate for the phase-in periods for implementation with respect to (i) the minimum standards for methodologies and (ii) the proposed framework for numerical haircut floors to be consistent with the other policy recommendations made in the Policy Document. Similarly, the phase-in period should have regard to the BCBS-IOSCO margin requirements for non-centrally-cleared derivatives.³

Cash-collateralised securities

AIMA supports minimum standards for cash collateral reinvestment provided such standards are sympathetic to the particular characteristics of a securities lending and repo transaction, e.g. potential stress testing for securities lenders and repo counterparties related to their ability to meet calls for return of cash collateral. While more stringent requirements are welcomed, these should be balanced against the potential of obstacles arising in respect of clients' financing needs.

³ See <https://www.bis.org/publ/bcbs261.pdf>



We thank the FSB for the opportunity to highlight the key areas of concern regarding the Proposals and we hope that you find this submission helpful. We would welcome the opportunity to discuss the contents of this submission in greater detail. Please do not hesitate to contact Jiří Król, Adam Jacobs or Wesley Lund of AIMA at +44 (0) 20 7822 8380 in this regard.

Yours faithfully,

A handwritten signature in blue ink, appearing to read "J Król", is written in a cursive style.

Jiří Król
Deputy CEO
Head of Government and Regulatory Affairs