The Actuarial Profession
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Consultation Response

The Basel Committee on Banking Supervision

Margin requirements for non-centrally cleared derivatives - Second consultative document

14 March 2013

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

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The Working Group on Margining Requirements
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

14 March 2013

Dear Sir/Madam

Margin requirements for non-centrally cleared derivatives - Second consultative document

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation. The consultation has been prepared by the Finance and Investment Practice Executive Committee.

Question 1: As we noted in our response to the first consultation (28 September 2012), we believe that there should be an exemption granted for short dated FX forwards and swaps with maturity of three months or less. Many of these contracts are traded for currency hedging purposes by a significant number of market participants who do not otherwise engage in OTC derivatives activity. We believe it is important not to discourage investors (who otherwise are not users of OTC derivatives) from using FX forwards for risk management purposes, as that would increase systemic risk. We believe that these investors should generally be able to meet their FX risk management requirements with contracts out to 3 months.

Longer dated FX forwards and swaps involve a higher degree of counterparty risk; therefore, it is appropriate they are treated consistently with the margining requirements for other non-cleared OTC derivatives.

Question 2: Our view is that the three proposed conditions would offer adequate protection of clients' interests to allow re-hypothecation of collateral by banks of customer positions. We believe this would help to keep the costs of trading OTC derivatives down.

Question 3: The proposed phase-in requirements do give adequate time for institutional investors to adapt to the operational requirements of the new regime. In particular, we welcome the proposal to permanently exempt financial institutions with less than €8bn notional of non-centrally cleared-derivatives.

In addition to the specific responses to the questions, we wish to re-emphasise our view (expressed as our response to Q14 in the previous consultation) that interest rate swaps and inflation swap exposures should be netted for margin requirements. Pension funds and insurance funds that hedge inflation-linked cash flows should not be required to separately margin the interest rate and inflation components of those hedges. It is not clear that these hedges would be treated as being within the same asset class (and so netting permitted) in the current BCBS/IOSCO recommendation.

If you have any further questions about our response, you should contact Philip Doggart, Policy Manager at the Institute and Faculty of Actuaries, (philip.doggart@actuaries.org.uk; or +44 (0)131 240 1319) in the first instance.

Yours sincerely

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Chris Watts
Chair, Finance and Investment Practice Executive Committee
The Institute and Faculty of Actuaries