Comments by Amundi on FSB's Guidance on Central Counterparty Resolution and Resolution Planning

(March 13, 2017)

Amundi is the largest asset manager in Europe with more than 1080 billion € under management at the end of 2016. After the announced acquisition of Pioneer, Amundi will rank in the top ten worldwide with 1300 billion € AuM. Established in more than 30 countries, Amundi offers dedicated investment solutions tailored to the needs of more than 100 million individual clients and 1000 larger institutional clients.

Amundi uses derivatives as an efficient way to adjust market exposure rapidly and inexpensively. The risks related to these derivative positions are carefully examined pre trade and constantly monitored. Risk management is part of asset management and we use risk mitigation techniques. Amundi supports the implementation of regulations like EMIR in Europe that increase safety and enhance investor protection. In particular we are attentive to the proper functioning of CCPs where risk will concentrate more and more and agree that supervisors should prepare for recovery and resolution procedures. They are viewed as a means to improve robustness and resilience of each CCP and, hence, enhance global confidence in the market.

Today we do not intend to become a full Clearing Member (CM), but we do consider new offers elaborated by some CCPs to offer "sponsored membership". We access CCPs indirectly through the clearing members we have selected and are very concerned that our client investors might be deprived from the property of their assets when using the services of a CCP.

Amundi's comments are articulated around these two directions : increase market confidence in robust CCPs and not alter investor protection even in stressed conditions.

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Amundi's comments will first be presented along a limited number of themes which we consider of vital importance. After these introductory points, we will produce comments on the different sections of the guidance. We shall not repeat the points we develop at the beginning but refer to them where appropriate.

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1. **CCPs participants should be considered as a distinct category:**

CCPs participants which are not clearing members (CM), for example like asset managers' funds and mandates, are not properly considered in the general discussion about CCPs and especially their potential resolution. Participants have indirect access to CCPs through their CM and they **pay a fee to benefit from the services provided by the CCP** (and the CM). We feel very strongly that they should be considered as totally different animals from CMs. Their situation is not properly analysed and described in the Guidance where we read that they are mentioned, not very often, together with CMs and seem to be seen as an extension of the CM in a kind of look-through approach. It is not the reality and we think that FSB should dedicate more time and effort to better assess the position of participants. We analyse that a CM creates an unavoidable intermediary between the CCP and the end investor who is a participant. As a **consequence there is no direct link between the participant and the CCP and no responsibility** can be passed onto the participants in case of default.

We have the following points and suggestions to express with determination:

- We **protest against VMGH**, i.e. the possibility that gains made by participants might be reduced by a Variation Margin Gains Haircut ; we note that VMGH, apart from being pure spoliation without legal basis, would immediately introduce a threat that hedging strategies might turn sour ; asset managers very often use derivatives as a hedging tool to cover existing risks : they would suffer the losses 100% and benefit from hedging only up to 80% if a 20% haircut were implemented.
- We acknowledge the fact that Haircut on Initial Margins (IMH) is not considered for participants and **suggest that the exclusion of IMH be explicit**. Regulators should ensure that it does not appear in the rulebook of any CCP when considering participants who are not CMs.
- With regard to access to information, participants are at a loss compared to CMs who have direct access to CCP. In most cases CMs are aware of the agenda of meetings such as risk committee or board of the CCP as they often are part of those or are consulted or informed immediately; participants rely on information transferred by CMs or read in the press; we advocate in favour of a **general information obligation by the CCP towards participants** on decisions impacting the operations, ahead of their application so that participants can adapt exactly at the same time as CMs.
- More specifically, we consider that **risk committees of CCPs should include end-clients**; it can only improve the functioning of CCPs by enlarging the scope of actors potentially impacted by decisions; if the CCP were not sufficiently diligent to publish what has to be announced, members of the committee should be recognized the right to inform their participant colleagues on those points where confidentiality has not been explicitly required at the meeting.

We want participants not to be prisoners of their CM, to be known and recognized by the CCP governance organization and not to suffer asymmetry in the information relating to the functioning of the CCP.

In our view, any contribution of participants who are not CMs to the allocation of losses process of a defaulting CCP is counterproductive. It is inconsistent with the objective to avoid contamination and to reinforce confidence in CCPs, market infrastructures and financial markets at large. It is not consistent either with the objective of maintaining full access for participants to their collateral, full access being not granted if the collateral is only partially available. It is not in conformity with civil law and property right. It is not different from payment by taxpayers, as eventually end clients in the case of asset management are individuals who have saved for their old age or paid an insurance premium or a medical insurance …and will eventually suffer a higher bill or a lower return or pension as a result of the "haircut" of participants' assets in case of resolution of a CCP. The only difference is that tax is usually proportional to revenue or wealth (contributive capacity) when loss allocation would have no correlation with them and end up being as widely spread in a far less equitable way than tax.

2. **Segregation of assets has a real impact :**

Since we are very conscious of our fiduciary duty towards our client investors who entrust us with the management of their money, we have paid attention to the differences that result from the various segregation regimes that are offered by CCPs. EMIR in Europe makes it mandatory for CCPs and CMs to offer a segregated solution next to the usual omnibus account solution. Participants had to insist on having full segregation made accessible at a reasonable cost and not intermediate LSOC or gross omnibus offers. There is not yet a total clarity on whether all CMs and CCPs offer Individual segregation arrangements on acceptable commercial terms.

In our analysis, **investors are much better protected against a default of the CM if they choose segregated accounts**. In case of default of the CCP segregated accounts offer a strong protection with respect to security collateral which is deposited in the hand of an external custodian. With respect to cash, specific protections exist in national law to identify clients' money and position it as bankruptcy remote. For funds run by asset managers the intervention of the depositary of the fund is an option to keep risk with a chosen and monitored counterparty.

Amundi is surprised that the Guidance does not introduce any discussion on the segregation of assets and the consequences in case of resolution of a total segregation in the books of the CCP. It is in our view, that of a participant, a key factor to consider and we urge FSB to extend the scope of its guidance to take stock of the position of participants and address the question of segregation of assets.

Related to that is the discussion about the **status of the CM. Agent or principal ?** We know that different legislations have different readings about this, but we believe that it is part of FSB's role to examine the issue. We would welcome guidance that would prevent CCPs' rulebooks to diverge too much and help participants in their negotiation. In our opinion, CCPs developed an agency model on listed derivatives and, even if OTC is based on principal to

principal transactions, we would prefer CMs to be qualified as agents between the participant and the CCP.

3. Uncertainty must be reduced where possible :

It is obvious that confidence and uncertainty are not aligned, especially in period of stress. Uncertainty increases risk and in period of stress risk is very negatively connoted and confidence disappears. Therefore it is of prime importance that actors have some visibility on possible scenarios and have guidance on the impact of the worst case scenario for them. It does not mean that future should be predetermined and that authorities should not have some flexibility to adjust to circumstances, but it requires some limits to be set. In that respect the **No Credit Worse Off rule** seems, at first sight, very considerate. However, we do not believe it will be of any help as its implementation is far too complex and burdensome. **A lawyers' delight with no real effect**. Litigation is unavoidable and each step can be disputed indefinitely since it refers to a theoretical reconstruction of history.

We prefer that guidance offer a few clear and **simple rules and introduce limits** that will provide actors with some way to manage risk. In that respect the clear difference made between default and non-default loss is satisfactory. Depending on the case, actors will be able to anticipate which type of instrument may be used and up to which limit for some of them. The limits and the position in the waterfall referred to in §2.9 is also helpful. In contrast, the absence of any limit on scope, duration or amount of VMGH (and empowerment to activate it) in §2.10 could be seen as an evidence of the poor consideration apparently paid to participants in the Guidance.

In terms of uncertainty, the most touchy question is the **timing of initiating the resolution** process. We agree that resolution authorities should be able to take over before all the possible devices foreseen in the statutes and rulebook of the CCP have been applied. The objective is to ensure continuity of critical activities and avoid contagion to maintain financial stability, it is not to test the efficiency of the existing tools. If the CCP has kept part of its own capital or guarantee fund it might be a great advantage to organize resolution, especially when the creation of a bridge entity and the liquidation of side activities is envisioned. We know that this approach which lowers moral hazard by reducing predictability of the process puts more pressure on authorities since they will have to exercise judgment to determine that resolution would be better than tentative recovery. But time is of the essence of the resolution of a crisis and therefore any acceleration in the planned process has a great chance to improve efficiency.

Amundi shares the view that resolution plan should not only be established and updated, but also that its enforceability should be tested. In that respect again we are convinced that uncertainty would not be acceptable.

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We now turn to the comments we have to produce section by section.

- **The overall objectives of CCP resolution and resolution planning (Section 1);**

Amundi agrees with the 3 principles which are listed in §1.2. FSB mentions participants and we agree that they are central in both objectives of (i) minimizing contagion effects or (ii) granting constant access to cash or collateral posted. We even consider that these two mentions imply that participants should not be exposed to any reduction of their assets even in case of resolution of the CCP since access to a reduced asset is not consistent with the second objective. Confidence requires public to feel safe and properly protected.

- **The powers that resolution authorities should have to maintain the continuity of critical CCP functions, return the CCP to a matched book and address default and non-default losses (Section 2);**

We agree that resolution **authorities should be granted exceptional powers of enforcement in exceptional circumstances**. Though, we think that they should not act without prior discussion with other authorities in different countries, both supervisory and resolution authorities, in order to share views on where the public interest lies. We further think that regional authorities and central banks (i.e. ESMA and ECB for €zone CCPs) should as well be consulted. However, we do envision that it might not be possible to consult in all cases and prefer direct transparent action if the alternative is excessive delay. Transparency and investor protection should be the key rules for the resolution authority.

The possibility to carry on procedures as foreseen in the CCP rulebook can be a possibility, but should not be a necessity as soon as powers have been transferred to a resolution authority. The protection of investors and the efficiency in ensuring continuity of critical activities are the drivers for any decision and they may justify to stop or skip rulebook's processes.

We think that the return to a matched book is central and expect that it would be achieved under the initial recovery process. Before coming into resolution the CCP would likely have tried "recovery" auctions to match the book and most of the times the resolution authority will have to take energetic steps like tear up of forced allocation. We do not oppose them if executed promptly and in a definite way and with a scope as limited as necessary. We insist on the remark in 2.5 (i) that **tear up should not be used as a tool to allocate losses.**

For losses allocation, Amundi considers that **end clients that use CCPs through CMs and pay a fee for the service they receive should not contribute in any way in the loss allocation process**. For non-default losses, it is for shareholders to pay first and mainly as it results from an inadequate organization. If CMs were called they should be entitled to an immediate compensation. For losses resulting from the default of a CM the default waterfall applies and guarantee funds as well as own capital of the CCP are

to be called to cover the losses. We oppose any taxation on margins, either initial or variation margins. As stressed in our preliminary remarks we believe that it would undermine public confidence in the central clearing system and develop the feeling that bilateral OTC trades are safer. We further encourage FSB to work on the advantage of incentivizing proper segregation of assets in order to protect participants and their client investors. In any case FSB's consultation document does not foresee any guarantee that VMGH would be used as a last resort tool on a decision made by the resolution authority and for a limited time, a limited amount, on a limited scope of contracts and with a priority compensation. It is not acceptable.

- **the potential indicators of circumstances that could lead to a determination to trigger resolution (Section 3);**

Amundi agrees that the wording "is or is likely to be" puts a real pressure on authorities to decide to move towards resolution. We think that it will in any case be a matter of judgment and we trust that authorities are best placed to take the best decision. We are not keen to make authorities liable for any potential loss for any creditor and prefer to maintain the idea that public authorities are liable when they openly do not fend for common public interest, including among others financial stability and investor protection.

- **the treatment of equity of existing CCP owners in resolution (Section 4);**

We read §4.2 as a statement that VMGH should not be considered as a means to allocate losses. The more so for Initial margins.

- **The application of the "no creditor worse off" safeguard and determination of the insolvency counterfactual (Section 5);**

From an intellectual point of view it is necessary to balance the long list of extraordinary powers that are attributed to authorities when resolving a CCP with a general principle of fairness. However, we are not convinced that the NCWO principle is anything else but a void concept. Its application is both very complex and not effectively protective of creditors interests. The question on who has the burden of evidence is not decided though it is of prime importance. Globally, we fear that it is unfair towards authorities to put them under such a far reaching obligation as NCWO and prefer to state that public authorities are liable if and only if it is apparent that they have failed to serve public interest.

- **the assessment of the adequacy of financial resources in resolution, including elements that the FSB should consider in future work on the quantum of resources for purposes of resolution (Section 6);**

We believe that, paradoxically, **public funds, i.e. taxpayers' money should be called**

before participants' money when they are not CMs. In that respect we suggest that the hierarchy elaborated in §6.7 be extended to clearly position end investors who hide behind the word participants at the very last resort, after public funding. In fact, financial stability is a global concern for all citizens and it makes sense that they all contribute as the final beneficiaries of a sounder and better economy. CCP's participants are also taxpayers as are their end client investors, but when they contribute to taxes according to their capacity as defined by legislators, they use the services of CCPs according to unrelated criteria like the appetite of their fund manager for active and efficient portfolio management or the structure of their (direct and indirect) savings. Calling participants money would create a distortion between countries, depending on how pension funds or personal savings are developed.

- **the aspects of resolution planning and resolvability assessments (Sections 7 and 8); and**

Amundi is appreciative of the requirement in section 8 to evaluate the feasibility and credibility of the resolution plan. Resolution planning is a didactic exercise whereby entities have to ask themselves what would be the most appropriate measures to take in case of a default. It is not a procedure on how to solve any type of problem and will not be implemented line by line. But the fact to have assessed the enforceability of the measures that are foreseen is essential when (if?) comes a crisis.

We thank FSB for including in §7.6 a reference to participants (indirect users) and to mandatory clearing as well as substitutability as part of the elements to take into account in the resolution plan. We urge FSB to recommend a capacity for authorities to **suspend mandatory clearing** when a CCP initiates a recovery process; the more so in case of resolution.

Concerning substitutability and portability, mentioned in § 8.1 and which is essential for participants, we suggest that FSB further investigate the feasibility and credibility of portability arrangements. In our view, at the level of a participant, portability is only workable if assets have been effectively segregated in the books of the CCP. We insist on CCPs' and CMs' obligation to offer full segregation arrangement at reasonable commercial conditions.

- **cross-border cooperation and the cross-border enforcement of resolution actions (Sections 9 and 10).**

No specific comment on that point.

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