

Amundi's response to FSB's Discussion Note on Essential Aspects of CCP Resolution Planning (October 17th, 2016)

Amundi is grateful that FSB opened this discussion note for consultation as it provides an opportunity to express our view on the resolution of CCPs. Publicly traded since November 2015, Amundi is the largest European Asset Manager in terms of AUM, with over 1,000 billion euros worldwide. Headquartered in Paris, France, Amundi has six investment hubs located in the world's key financial centers and is very attentive to the evolution of the market infrastructures and their contribution to financial stability. Our focus is placed on the security of assets we manage on behalf of our client investors. We do not want to put them at risk when we trade derivatives that are very useful in order to optimize performance/risk of many investment strategies. Amundi is the trusted partner of 100 million retail clients, 1,000 institutional clients and 1,000 distributors in more than 30 countries, and designs innovative, high-performing products and services for these types of clients tailored specifically to their needs and risk profile.

CCPs are a good example of infrastructures that have been placed in the midst of the new regulatory framework aiming at enhancing financial stability and reducing risk on derivatives markets. For example, EMIR in the EU foresees mandatory central clearing for OTC derivatives that are sufficiently standardized, liquid and whose price is easily accessible. As a result, CCPs concentrate the counterparty risk that was before split among different counterparties individually selected. It represents a major challenge for authorities to make sure that these infrastructures will be sufficiently strong and resilient to avoid defaulting. Any default would undoubtedly bring systemic consequences. Therefore, the current discussion on Recovery/Resolution is key for the entire financial community and for us as asset managers.

Amundi does not intend today to become a direct clearing member of a CCP. We do believe that banking activities should be carried by licensed banks that present the adequate minimum capital requirements. We are clients of clearing members and are highly selective when considering the choice of partners, both clearing members and CCPs. We examine carefully the financial capacity of CCPs, their default waterfall and the "skin in the game" that act as protection for end clients as ourselves and our client investors. This is the point of view we have as a buy side representative when answering the questions of the present discussion note.

To start, we would like to underline our key convictions without any order of importance:

1. We share the objective as defined in §1.1 and suggest that the 3 points mentioned in the first sentence are not to be put at the same level. In our view there is one objective which is to organize “continuity of critical functions of the CCP”; if achieved, financial stability will be enhanced, as a consequence; furthermore, there is a constraint not to expose taxpayers to risk of loss and we see it as a strict requirement not a loose objective;
2. We consider that taxpayers money should not be considered only through the tax they pay, but also through all types of payments that they could indirectly be required to do; we are very much concerned that end clients on the buy side of the CCPs may have to support any loss in case of difficulties or even default of a CCP; client savings are to be exempt from any indirect taxation resulting from participation in the default waterfall of a CCP;
3. We oppose the introduction of flexibility in the rules of CCPs that would result to an end client being called to pay to reestablish a defaulting CCP; more specifically we refuse the assertion in §7.5 that “imposing losses on all creditors in this ... would present the resolution authority with a pool of financial resource from which to draw on”.

Now we turn to our answer to those questions of the consultation where we feel we have some comments to share. We will not address all questions.

Q1. Does this discussion note identify the relevant aspects of CCP resolution that are core to the design of effective resolution strategies? What other aspects, if any should authorities address?

We believe that authorities should pay **more attention to the buy side**. End investors are indirect clients of CCPs either spontaneously or by law. The incentive for them to clear through CCPs very much depends on the assurance they have that their assets will not be at any risk, even in case of default of a CCP. End clients do not sufficiently participate to discussions on the calibration of guarantee funds, capital, “skin in the game” and default waterfall of CCPs. Clearing members and CCPs are very close in the ecosystem and there is a risk that they take options that eventually will hurt end investors.

Incentive effects of resolution strategies

Q2. What is the impact on incentives of the different aspects of resolution outlined in this note for CCP stakeholders to support recovery and resolution processes and participate in central clearing in general? Are there other potential effects that have not been considered?

Please see our response under question 1.

Timing of entry into resolution

Q3. What are the appropriate factors for determining timing of entry into resolution? How might a presumptive timing of entry (or range of timing), if any, be defined in light of the criteria set out in the FMI Annex to the *Key Attributes*? If defined, should the presumptive timing of entry be communicated to the CCP and its participants?

We agree that flexibility is necessary to manage a recovery process. However the time when the authorities will decide to switch from recovery to resolution is of the utmost importance; the question should be **monitored on a continuous basis** and indicators should be defined in advance in order to analyse when to change process. In any case, **an orderly resolution implies that there is sufficient capital for the CCP to face it**. Authorities should allocate a limited amount of capital to the resolution process and keep a generous cushion to achieve an eventual resolution at the lowest cost for the community. Other criteria would relate to the momentum of the recovery process, the velocity of the movement towards improvement and squaring the book, the support by stakeholders, the estimated risk of contagion to other CCPs...

Adequacy of financial resources in resolution

Q4. Should CCPs be required to hold any additional pre-funded resources for resolution, or otherwise adopt measures to ensure that there are sufficient resources committed or reserved for resolution? If yes, what form should they take and how should they be funded?

As a client of CCPs, we maintain that the following principles should prevail:

- Pre-funded resources are the only ones to be available and authorities should demand prefunding to a large extent, not to say of all types of capital and guarantee funds;
- Prefunding avoids procyclicality;
- In respect to §4.9, prefunding must be **provided by shareholders and members only and not by clients**; we agree that the best risk free investment is deposit at the central bank and suggest it to be the rule for a majority of the own capital of a CCP; the opportunity cost is small compared to the necessity to avoid risk;
- Access to **central bank money** is key to ensure liquidity in all circumstances; the proximity that a mandatory deposit for CCPs with the central bank would create is positive in terms of better knowledge of CCPs by central banks.

Q5. How should the appropriate quantum of any additional CCP resources be determined? In sizing the appropriate quantum, what factors and considerations should be taken into account? Do your answers vary for default and non-default losses?

Amundi does not think that there is any difference between default and non-default losses. **They are losses and must be replenished in the same manner.** The only apparent

distinction relies on the fact that non-default losses should be easier to rapidly assess and are of a less dynamic nature.

Q6. Should resolution funds external to the CCP be relied upon? If so, how should such funding arrangements be structured so as to minimise the risk of moral hazard, including for CCPs with significant cross-border participation? Where these are pre-funded, how should the target size be determined and which entities should be required to contribute?

Please see our answer to question 4 above.

Tools to return to a matched book

Q7. What factors should the resolution authority consider in choosing and exercising tools to return the CCP to a matched book? Is one (or more) of the tools for restoring a matched book preferable over others and if so, why?

As end clients of CCPs, we do not favour the forced allocation or tier up of contracts. It would put our portfolios, and ultimately our client investors, in a position where they might be exposed when thinking that they are hedged. This type of uncertainty creates non manageable risk.

What is of importance for us is to be able to rapidly identify which the consequences of a recovery procedure are (and not might be) for our portfolios. **Risk management relies on exact data and cannot suffer uncertainty on exposures.** And asset management is largely a question of risk management.

Q8. Should any tools for restoring a matched book only be exercisable by resolution authorities? If so, which tools and subject to what conditions?

Allocation of losses in resolution

Q9. What are in your view effective tools for allocating default and non-default losses and what are the pros and cons of these tools? Should initial margin haircutting be considered as a tool for the allocation of losses in resolution? Is one or more of the tools preferable over others? What are your views on the use of tools to restore a matched book as a means of loss allocation?

No, **we do not consider that initial margin haircutting can in any manner be a tool to allocate losses.** Initial margins are calibrated to cover the default of each individual counterparty; they are evaluated every day and are subject to daily calls for replenishment. They are not monies available in the CCP for authorities to use them to allocate losses. If there were to be a risk on initial margins deposited by an end investor it would undoubtedly lead to the development of non-cleared transactions where the effective risk is far better under the control of the counterparties.

We insist on the fact that margins, even excess and variation margins, are not representative of profits or gains and they are not “taxable”. When a fund gains on a derivative position, it is likely to be a hedged position with an opposite exposure on another instrument within its portfolio.

There is a final general comment we would like to express with reference to loss allocation. Since shareholders and members are to suffer losses it is for end clients of high importance to make sure that they will not tend to pass the cost onto them. Regulation should help end investors to get such a confirmation and the **regulation should provide that responsible entities cannot transfer their risk or losses onto clients.**

Q10. Which, if any, loss allocation tools should be reserved for use by the resolution authority (rather than for application by a CCP in recovery)?

Q11. How much flexibility regarding the allocation of losses is needed to enable resolution authorities to minimise risks to financial stability? For example, to what extent should a resolution authority be permitted to deviate from the principle of pari passu treatment of creditors within the same class, notably different clearing members in resolution? What would be the implications of a resolution strategy based primarily or solely on a fixed order of loss allocation in resolution set out in CCP rules vs. a resolution strategy that confers discretion to the resolution authority to allocate losses in resolution differently to CCP rules?

We consider that procedures as written by the CCP and approved by authorities are the result of an extensive work of in depth analysis of pros and cons of each different solution. We hate to think that authorities could depart from the existing and published rules. *Dura lex sed lex* means that when the rule exists it must apply.

Our opinion is that **flexibility in the application of the rules creates uncertainty**, that will backfire as a threat among investors that they might be called for cash. Ultimately it is most likely to be a killer of confidence and trust in market infrastructures.

There is, however room for rules to foresee alternative routes at a given point and to explain how authorities may decide to choose one or the other. But they must be limited in impact and not modify the substance of the rule which has to be: shareholders and members are the only ones to contribute to losses.

Q12. What are your views on the potential benefits or drawbacks of requiring CCPs to set out in their rules for both default and non-default losses:

- (i) The preferred approach of the resolution authority to allocating losses;
- (ii) An option for, or ways in which, the resolution authorities might vary the timing or order of application of the loss allocation tools set out in the rules?

Procedures can include limited variations as long as they do not reduce the “skin in the game” and maintain the principle that **only shareholders and members of the CCP will contribute to losses.** The best way to achieve that is to foresee that the choice between two

alternative routes (that have to be described in the procedure ex ante) can only be made, at a qualified majority, by the governing body of the CCP.

Non-default losses

Q13. How should non-default losses be allocated in resolution, and should allocation of non-default losses be written into the rules of the CCP?

We agree that the differentiation between losses relating to a default and other losses is of interest when analyzing the possible scenarios. However, we think that **non-default and default losses should be treated in the same manner**. The default waterfall should run the same way, starting at a lower level where there is no longer any first allocation to a defaulting member that would not exist. Thus, we believe that it is not difficult for a CCP to include this case of non-default losses in its procedures. It should be done.

Q14. Aside from loss allocation, are there other aspects in which resolution in non-default scenarios should differ from member default scenarios?

Application of the “no creditor worse off” (NCWO) safeguard

Q15. What is the appropriate NCWO counterfactual for a resolution scenario involving default losses? Is it the allocation of losses according to the CCP’s rules and tear-up of all the contracts in the affected clearing service(s) or liquidation in insolvency at the time of entry into resolution, or another counterfactual? What assumptions, for example as to timing and pricing or the re-establishment of the CCP’s matched book, will need to be made to determine the losses under the counterfactual?

If NCWO provision looks great and highly protective at first sight, it rapidly appears that it is very complex to implement. We think that :

- The general principle that CCPs and authorities take their decision in the best interest of stakeholders and not their personal interest is sufficient a safeguard ;
- The risk that counterfactual scenarios will create is one of never ending judicial procedures with trials that will last years and cost lots of money (meaning fees for lawyers);
- Ex post remedies of ex ante decisions resulting in damage when compared to hypothetical “what if” scenarios is not going to bring confidence in market infrastructure.

Therefore, **we would recommend not to develop this NCWO approach** and we suggest to mention that fair conduct is expected from decision makers especially when market infrastructures are concerned. One should also consider setting up market infrastructures as public entities without conflicting interest and totally devoted to public good.

Q16. What is the appropriate NCWO counterfactual for a resolution scenario involving non- default losses? Is it the liquidation of the CCP under the applicable insolvency regime, assuming the prior application of any relevant loss allocation

arrangements for non-default losses that exist under the CCP's rules or another counterfactual?

Q17. How should the counterfactual be determined in cases that involve both default losses and non-default losses?

Equity exchange in resolution

Q18. Should CCP owners' equity be written down fully beyond the committed layer of capital irrespective of whether caused by default or non-default events?

We do not see any difference: losses are losses and should be covered by capital and own resources. Irrespective of the fact that they are default or non-default losses.

Q19. Should new equity or other instruments of ownership be awarded to those clearing participants and other creditors who absorb losses in resolution?

When there is a call for capital, it must be conducted according to the articles of incorporation and the internal rules of the CCP. If some shareholders and clearing members wish to sell or subscribe to the capital increase, there is no discussion that commercial law rules should apply. Capital awarded in exchange for other types of liabilities is again **a matter of commercial law** that has not to be predetermined in the rules of the recovery or resolution plan.

Cross-border cooperation

Q20. What are your views on the suggested standing composition of CMGs? Should resolution authorities consider inviting additional authorities to the CMG on an ad-hoc basis where this may be appropriate?

We agree that the composition of the Crisis Management Group, CMG, is paramount to make the recovery or resolution process a success. We support the suggestions made in §10.3 and 10.4 to build a standard CMG and be able to invite, on a case by case basis, other authorities to participate. §10.3 rightly mentions supervisory authorities, resolution authorities and central banks as members of the CMG. We agree that authorities of the home jurisdiction of the CCP should be joined by authorities of other countries **where the CCP is active, where its main members are, where the underlyings of its contracts are traded and where the main clients are based**. We think that adding a reference to clients is of relevance: it is time to take buy side on board. The diversity of nationalities will help to gain a transversal view and allow to better assess the risk that a difficulty may spread to other markets and CCPs.

Q21. What should be the nature of engagement with authorities in jurisdictions where the CCP is considered systemically important, for the purpose of resolution planning and during resolution implementation?

Q22. Should CCP resolution authorities be required to disclose basic information about their resolution strategies to enhance transparency and cross-border enforceability? If so, what types of information could be meaningfully disclosed without restricting the resolution authority's room for manoeuvre?

Our opinion is that resolution authorities are bound by the internal rules of the CCP that are available to the public. In that respect it might be consistent to include the resolution authority in the process of agreement of a CCP. But internal rules do not go as far as describing resolution or recovery strategies. Though, they strictly define the process for losses allocation through their default waterfall. We consider that the resolution authority should limit its communication to a few **general principles**:

- Its action aims at ensuring continuity of central clearing considered as a critical function for the market
- Its decisions are deemed to best serve the common interest of all market participants;
- It shall be bound by official rules of the CCP such as the process to allocate losses according to the default waterfall and will not deviate from them;
- It keeps some flexibility in the usage of instruments and timing;
- It continuously monitors the advantage of switching from recovery to resolution in order to move before it becomes too late.

Cross-border effectiveness of resolution actions

Q23. Does this section of the note identify the relevant CCP-specific aspects of cross-border effectiveness of resolution actions? Which other aspects, if any, should also be considered?

Q24. What should be the role, if any, of the suspension of clearing mandates in a CCP resolution and how should this be executed in a cross-border context?

We support the idea that **a coordinated suspension of mandatory central clearing is a very powerful tool** to maintain market activities and lower the risk of spreading anxiety and volatility. Being able to trade on a bilateral way will allow, first, to continue acting on the market as usual, second, for time to prepare a transfer from one clearing member to another or from CCP to another without undue pressure. It also reduces the cross margining between CCPs, hence, the systemic risk of cross default.

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