Mr Mark Carney
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Financial Stability Board

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Financial Stability Board

Consultations: Application of the Key Attributes of effective Resolution regimes to non-bank financial institutions and Information sharing for resolution purposes

Dear Mr Carney,

The Investment Management Association (IMA) is the trade body for the UK asset management industry, representing around USD5 trillion of funds under management. Its member firms include managers of a wide range of asset classes for a wide range of clients, including institutional funds, authorised unit trusts and open ended investment companies.

We welcome the opportunity to comment on the latest consultations. We comment on Appendix I (the resolution of FMIs) and Appendix III (client asset protection in resolution) of the Consultative Document. The IMA has no comment on Appendix II (the resolution of insurers).

Our engagement with banks, broker/dealers and financial market infrastructures are multiple: shareholders, lenders (by way of buying their bonds), wholesale depositors and users of their services (detailed in Annex 2).

Key messages

We support the efforts of the authorities, at all levels, to implement recovery and resolution regimes and, with regard to cross-border financial institutions, to align their approaches.

General comments

The IMA is of the opinion that the priority for the resolution authority is to ensure continuity of the crucial infrastructure services considered as systemically important. In this respect, any issues in terms of the corporate structure of the FMI should not be allowed to present barriers.

The guidance should provide for transparency requirements in order to ensure appropriate information to all stakeholders in relation to the FMI. Although the IMA acknowledges that a

resolution plan may be specific and that any decision from authorities will have to be tailored to the actual situation of the concerned FMI, some degree of transparency is necessary for participants to assess their risks in using and participating in FMIs.

We note that the proposals do not recognise the differences between FMIs. At least, central counterparties (CCPs) would need bespoke recommendations, which would follow what is being proposed. For other FMIs, the consequences of a default may not be as severe from a capital perspective and thus the resolution tools could be different.

Resolution of financial market infrastructure (Appendix I)

The IMA supports the statutory objectives of effective resolution, namely pursuing financial stability and allowing for the continuity of critical functions without losses for taxpayers.

There should be principles regarding close-out netting even in resolution. Close-out netting is used in capital markets, contributing to sound risk management.

Loss allocation to clients and indirect clients should be considered as a resolution tool, not recovery. Resolution authorities alone should have the power to enforce the implementation of such transfers.

The IMA, in principle, supports the principles listed in the Consultative Document, according to which reducing or writing down variation and initial margins should only be allowed in circumstances where the FMI's services are critical.

Loss allocation rules should never be determined by the FMI alone, but they should be drafted together with, at least, the authorities and clearing members. These rules should be transparent to clients of the FMI.

With regard to the the funding of resolution, we believe that losses incurred by the government should be recovered from shareholders. Only as a last resort only, should these losses can be recovered from FMI participants. Any obligation to recover losses from the financial system is likely to lead to a threat to the financial stability and cause uncertainty in the capital markets.

Most, if not all, of the information listed under "Access to Information and information sharing" should be published.

Client asset protection in resolution (Appendix III)

We agree that client asset protection is an important feature of any recovery and resolution plans.

It is good that the existence of different client regimes has been taken into account. The term "client" can mean many things. In some jurisdictions, client assets can be understood as those belonging to the end investor (a natural or legal person) whereas in others, "client" can mean the next institution in the chain. Therefore, local regulators should have the final say.

With regard to the recovery, in particular, and resolution of CCPs, we have the following comments about loss allocation:

We suggest that it is important to develop a higher level conceptual framework for considering the tools. This is because it is not merely a question as to whether something is an appropriate tool, but how those tools interact and how they reflect governance of the CCP. There are three sets of assets which can bear loss, and each is owned by a different group, with different incentives and responses to risk of loss and actual loss, and each can impact wider financial stability differently.

The three broad sets of assets which can bear losses are:

1. The Intrinsic Capital of the business: – provided by the owners and given it is equity it must be expected to bear loss. They should have a keen incentive to ensure the business is not run riskily and in relation to whom total loss may or may not lead to wider contagion (since the beneficial owners need not be financial institutions). There is likely to be a relatively low turnover in the identity of the owners which should operate to maintain their ability to demand appropriate behaviour from management.

2. The Default fund: – provided by the participants for the very purpose of dealing with loss. The participants also have an incentive to consider the overall risk management of the CCP. There is likely to be a very low turnover in the identities of this group given the cost of entry. Both these characteristics mean they should therefore be provided with tools to demand changed behaviour – as in EMIR with their role on the risk committee. Total loss of the default fund is likely to impact other financial institutions but equally they are likely to be a source of the most significant loss (outside of management's poor behaviour).

3. The aggregate of the transaction-related assets: - essentially the margin supplied by users and indirect participants. These funds are provided for transaction-related losses by a constituency with the highest turnover. Initial margin should not be considered to be available for losses that are the fault of the CCP's management, but, even where there are discussions about subjecting variable margin to a haircut, it must not be forgotten that the providers of these assets can do little to influence good behaviour at the CCP. Total loss is likely to impact the wider financial system but these players can choose to change their behaviour and not transact business (at least in theory though mandatory clearing on to monopolistic CCPs means many have little alternatives).

   We offer this framework to allow a consideration of how the relative sizes of each set of assets should be agreed and why. We suggest the traditional position that a business should have capital to bear losses to which it may be subject is valid for CCPs. Indeed, there could be a range of capital instruments used, including bail-inable capital.

Conclusion

The IMA looks forward to working with the international standard setters to develop a framework that is appropriate and effective for all stakeholders.

Annex 1 to our letter contains our formal response to the consultation, and further specific observations and questions arising from the proposals.

Annex 2 summarises the critical functions that are essential for the asset management industry to survive.

We hope that you will find our comments useful. Please contact us by way of e-mail (gsears@investmentuk.org and ihenry@investmentuk.org) or telephone on (00 44) (0) 20 7831 0898 should you require further information.

Yours sincerely,

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Annex 1

Draft Implementation Guidance: Resolution of Financial Market Infrastructure (FMI) and Resolution of Systemically Important FMI Participants Questions for consultation

Part I of the Draft Guidance: Resolution of Financial Market Infrastructure

1. Does the draft guidance adequately cover the principal considerations that are relevant to the resolution of each class of FMI (CCPs, CSDs, SSS, PS and TRs)? Would it be helpful if the guidance distinguished more between different classes of FMI? If so, please explain.

It would be helpful to make guidance bespoke. For example, CCPs should be addressed separately from central securities depositories (CSDs) as the former take credit risk from both sides of the transaction, sit on a default fund and hold assets, i.e. they are not so different from systemically important banks (SIBs). Therefore, we believe that CCPs should have a special resolution regime, as banks do in the United Kingdom.

2. Should any further distinction be made in the draft guidance, for the purposes of applying the Key Attributes, between types of FMI that assume credit risk through exposures to participants and those that do not? If so, for which provisions is that distinction relevant?

As above, credit risk is the key driver.

3. Are the additional statutory objectives for the resolution of FMI (paragraph 1.1) appropriate? What additional objectives (if any) should the draft guidance include, relating either to FMIs generally or specific classes of FMI?

The objectives listed are sufficient. There is often a public policy reason for additional aims.

4. Is it appropriate to exclude FMIs that are owned and operated by central banks from the scope of application of the Key Attributes and this guidance (paragraph 2.1)?

We believe that ownership should not (unduly) influence the application of these guidelines. Counterparties may misinterpret such factors.

5. Should resolution authorities have a power to write down initial margin of direct or (where appropriate) indirect participants of an FMI in resolution (paragraph 4.8)? If so, should the power be restricted to initial margin that is not 'bankruptcy remote' and may be used to cover the obligations of participants other than the participant that posted it? What are the implications of such a power for FMIs and participants? Are any further conditions appropriate in addition to those specified in paragraph 4.9?

We believe that the resolution authorities should consider the different sources of money that can be used to restore the capital adequacy of the FMI, i.e. its share and convertible bond holders, transactional assets (e.g. variable margin) and, in the case of CCPs, the default fund. Initial margin is just one source of money for recapitalisation.

6. Should the Annex explicitly restrict resolution authorities from interfering with the netting rights of FMI participants (for example, by splitting a netting set through partial transfer of positions in a CCP or partial 'tear up' of contracts)? What is the possible impact on participants' risk management, accounting reporting or regulatory capital requirements if

netting rights can be interfered with in resolution, and how might any such impact be mitigated?

Ideally, the authorities would not, but all parties may have to be flexible in such a situation.

7. Does the draft guidance (paragraphs 4.1 and 4.2) adequately address the specific considerations in the choice of the resolution powers set out in KA 3.2 to FMIs? What additional considerations (if any) regarding the choice of resolution powers set out in KA 3.2 that should be addressed in this guidance?

The considerations are sufficient.

8. Are the conditions for entry into resolution of FMI (paragraph 4.3) suitable for all classes of FMI? What additional conditions (if any) would be relevant for specific classes of FMI?

These conditions are sufficient. We agree with the authorities that the emphasis should be on recovery.

9. Does the draft guidance (and paragraphs 4.4, 4.8 and 4.9 in particular) deal appropriately with the interaction between the contractual loss-allocation arrangements under the rules of certain classes of FMI and the exercise of statutory resolution powers?

Yes, the guidelines cover the interaction.

10. Should contractual porting arrangements be recognised in the draft guidance on the transfer of critical functions (paragraphs 4.11 and 4.12)?

Yes, these arrangements should be explicitly recognised. Advance agreement should be secured when FMIs and relevant service providers obtain authorisation and begin to trade. If need be, there should be memoranda of understanding between FMIs and their supervisors, and contracts checked by supervisors to facilitate porting.

11. Are there any other FMI-specific considerations regarding the application of any of the resolution powers set out KA 3.2 that should be covered in this guidance?

We do not believe so.

12. Does the draft guidance (paragraphs 5.1 and 5.2) deal appropriately with the considerations that are relevant to the decision whether to stay the exercise of early termination and set-off rights by FMI participants on the entry into resolution of the FMI? Should the guidance distinguish between different classes of FMI in this regard?

The guidelines can be interpreted, giving the authorities and participants flexibility.

13. Are loss-allocation arrangements under FMI rules reflected appropriately in the application of the “no creditor worse off” safeguard in FMI resolution (paragraph 6.1)?

Yes, the arrangements support the principle.

14. What additional factors or considerations (if any) are relevant to the resolvability of FMIs, or particular classes of FMI (paragraphs 10.3 and 10.4)?

We believe that the factors detailed are sufficient.

15. Are there additional matters that should be covered by resolution plans for FMIs or particular classes of FMI (paragraphs 11.6 and 11.7)? If yes, please elaborate.

The aspects of resolution detailed are sufficient. The authorities should encourage, if not incentivise with relief from regulatory measures, the substitutability of services and portability of contracts.

16. Are the proposed classes of information that FMIs should be capable of producing (paragraph 12.1) feasible? Are any of the proposed classes of information unnecessary, duplicative or redundant? What additional classes of information (if any) should FMIs be capable of producing for the purposes of planning, preparing for or carrying out resolution?

The types of information should be feasible to produce. The authorities should work with participants to ensure that is the case. In addition, the reporting should be in such a way as to ease comparison of data and facilitate the transfer of business, contracts etc.

As per the reforms mandated by the G20, firms are having to gear up for greater reporting than pre-crisis. The authorities and firms should look at the reporting requirements holistically, minimise duplication etc.

17. Are there any other issues in relation to the application of the Key Attributes to FMIs or particular classes of FMI that it would be helpful for the FSB to clarify in this guidance? If yes, please elaborate.

No comment.

Part II of the Draft Guidance: Resolution of Systemically Important FMI participants

18. Does the draft guidance achieve an appropriate balance between the orderly resolution of FMI participants and the FMI's ability to manage its risks effectively?

Yes, the balance is right. In addition to FSB guidelines, local regulators will have their own issues to address, including governance.

19. What actions of the FMI in relation to failing participants could hamper its orderly resolution? How could the impact of such actions on orderly resolution be mitigated or managed?

Participants and the authorities will have to be aware of the risks of contagion from one FMI to another plus a participant in one FMI failing in another, especially banks and CCPs as the pool is limited.

20. Are the safeguards set out in the guidance (paragraph 1.3) adequate as regards the conditions and requirements for maintaining access of a firm in resolution or admitting as a new member an entity to which that firm's activities have been transferred? If not, what additional safeguards should be included in the guidance?

The safeguards are sufficient.

21. Are there any other issues in relation to the handling of the failure of FMI participants that it would be helpful for the FSB to clarify in this guidance? If yes, please elaborate.

No comment.

Draft Implementation Guidance: Client Asset Protection in Resolution Questions for consultation

34. Are the distinct but complementary roles of the draft FSB guidance and the IOSCO Recommendations Regarding the Protection of Client Assets sufficiently clear?

Yes, the differences are clear.

35. Does the draft guidance deal adequately with the different types of firms and the range of their activities in the course of which they hold client assets, including investment business, prime brokerage and custody services? If not, what additional types of firms or activities should be covered?

The guidelines are clear. We urge the authorities to monitor implementation, especially the local definition of client assets and money, so that there is no circumvention, e.g. to protect local investors at the expense of foreigners.

36. Are the additional statutory objectives for the resolution a firm with holdings of client assets (paragraph 1.1) appropriate? What additional objectives should be included?

The aims are appropriate, clear and sufficient.

37. Is the proposed definition of 'client assets' (paragraph 2.1) sufficiently comprehensive? Are there any other classes of assets (in addition to those specified in paragraph 2.2) that should be excluded from the scope of this guidance?

The definition is comprehensive and understandable. The exclusion of bank deposits, insurance assets and claims, and collateral (as per repos and reverse repos) is fine.

There are definitions, for example of bank deposits, which occur in other frameworks, such as the Basel accords. These should be aligned.

As above, we urge the authorities to monitor implementation, especially the local definition of client assets and money, so that there is no circumvention, e.g. to protect local investors at the expense of foreigners.

38. Does the draft guidance (paragraphs 3.1 to 3.5) cover all relevant issues concerning the exercise of transfer powers in relation to client assets? If not, please explain what additional issues should be covered.

The proposed guidelines are broad enough to facilitate transfers.

39. Is the interaction between transfer powers and contractual porting arrangements or other arrangements under the rules of CCPs, exchanges or trading platforms (paragraph 3.3) sufficiently clear? If not, please explain what aspects might usefully be clarified.

40. Should the guidance be more prescriptive in relation to arrangements for the identification and safeguarding of client assets, including segregation, that are necessary to enable resolution authorities and administrators quickly to identify client assets and ascertain the nature of claims to those assets (paragraph 4.1)? If so, how?

The guidelines are fine. Local regulators are sure to have their own interests and make more prescriptive.

41. Are there arrangements other than segregation that are capable of achieving the outcome described in paragraph 4.1? If so, please explain what other arrangements are currently used.

Reporting will also assist.

42. Are the requirements for firms to maintain adequate records in relation to securities lending (paragraph 4.3(i)) and re-hypothecation (paragraph 4.3 (ii)) sufficiently clear and specific as to the standard that is required? Are they sufficient to enable a resolution authority or administrator to act swiftly and with certainty? If not, please elaborate.

The rules are clear, but need to be backed up with sanctions, for both firms and employees.

43. Is the requirement regarding adequate disclosure by firms to clients of the effects of asset lending, rights of use or re-hypothecation (where permitted) on the protection of client assets in resolution (paragraph 4.4) sufficiently clear and specific as to the standard that is required? What additional disclosure or information requirements relating to re-hypothecation (if any) should be included in the guidance?

The rule is clear, but, as above, there should be penalties for breaches.

44. Is the draft guidance regarding re-hypothecation consistent with the recommendations of other FSB workstreams, such as Recommendations 9 and 10 in the FSB, Consultative Document, Strengthening Oversight and Regulation of Shadow Banking, A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos (18 November 2012)? Please explain any inconsistencies.

The proposed guidelines are consistent with last year's shadow banking proposals.

45. Are there any other requirements in relation to securities lending and re-hypothecation that would support clarity as to clients' rights in resolution in relation to assets that have been lent or re-hypothecated? If yes, please elaborate.

No comment.

46. Does the draft guidance (paragraphs 6.1 and 6.2) adequately cover the challenges for resolution authorities or administrators in dealing with client assets that held in a different jurisdiction to the firm in resolution? Please outline any additional aspects that might usefully be covered by the guidance in this regard.

The proposals are sufficient. There should be colleges of supervisors for FMIs, as there are for banks, should there be cross-border elements.

47. Does the draft guidance (paragraph 7.1) set out the principal matters that should be considered and addressed in resolution planning for firms with holdings of client assets? What additional considerations (if any) are relevant for all such firms, or firms that carry out particular activities involving the holding of client assets?

The measures address the issues and ease recovery and resolution.

48. Are the classes of information that firms should be able to provide promptly in order to facilitate the rapid transfer or return of client assets (paragraph 8.1) feasible? What additional classes of information (if any) should firms be capable of producing for those purposes?

The types of information should be feasible to produce. The authorities should work with participants to ensure that is the case. In addition, the reporting should be in such a way as to ease comparison of data and facilitate the transfer of assets.

As per the reforms mandated by the G20, firms are having to gear up for greater reporting than pre-crisis. The authorities and firms should look at the reporting requirements holistically, minimise duplication etc.

49. How far should information requirements also extend to CCPs, exchanges and trading platforms?

All parts of the financial system should be required to provide information and promote financial stability.

50. Are there any other issues in relation to protection of custody and client assets in resolution that it would be helpful for the FSB to clarify in this guidance?

No comment.

Annex 2

As per the key messages, the functions that are of importance to the fund management industry are as follows:

1) Payments, clearing and settlement

These services are provided by banks to their clients. Some services may be provided by a non-bank entity of the firm, e.g. broker-dealers. Such services are often on a cross-border basis, e.g. foreign exchange clearing and cash management.

The drivers of criticality are market concentration and the availability of substitutes, geographical footprint, complexity of services and asset classes for clearing, links to ancillary services (transaction accounts (including collateral for transactions), deposits and custody) and the reliance of financial market infrastructure (FMI) providers on banks.

2) Wholesale activities

This refers to lending and borrowing in the wholesale markets between financial counterparties. Stress can lead to funding and liquidity strains if the firms are of systemic importance (e.g. major providers of liquidity and/or funding by short-term deposits (net stable funding ratio)).

The drivers of criticality are systemic importance and interconnectedness, market concentration, maturity transformation and leverage.

3) Clearing activities

This is about the issuance and trading of securities, often related to advisory services and prime brokerage. Such activities rely on payment, clearing and settlement functions.

The drivers of criticality are market concentration and the availability of substitutes, whether services are bundled, and the portability of client accounts across providers and markets.