

## **ESMA'S CONSULTATION PAPER ON DRAFT TECHNICAL STANDARDS FOR THE REGULATION ON OTC DERIVATIVES, CCPS AND TRADE REPOSITORIES**

Amundi is a leading asset manager ranking second in Europe and among the top ten worldwide with assets under management amounting to 658 Bns € at the end of 2011. Manager of many mandates and funds implementing many different strategies, Amundi is active on the derivatives markets both listed and OTC. It fully understands and supports the global approach to reduce risks occurring from the use, or abuse, of derivatives that drives the efforts by authorities to enforce appropriate regulation on an international basis.

Amundi would like to seize the opportunity of this consultation in order to explain some issues that really matter for its current activities and could be badly and unnecessarily impacted by an inadequate regulation. Amundi wishes first to thank ESMA for providing this opportunity to express those concerns and try and build a better regulation.

Comments will follow the presentation as it appears in the consultation paper (with the order number). Not all items will be discussed, but only those where Amundi wishes to express a comment.

### **III. OTC DERIVATIVES:**

#### **III.1 Clearing obligation**

#### **III.2 Clearing obligation procedure:**

Criteria used by ESMA to pronounce a mandatory clearing are rightly different from those used by the local authority to authorize clearing by a CCP. It then belongs to ESMA to regularly assess that the criteria are still met in order to reaffirm or dismiss the mandatory clearing. This point, if correct, should be mentioned in the text and a proper procedure defined in the RTS or in each RTS relevant to any new derivative submitted to mandatory clearing.

Standardisation includes a reference to both common legal documentation and (automated) post trade common practices. Legal templates should be able to be developed under different national laws provided they are sufficiently adaptable to common international dealings and accepted by the relevant CCP's. It should not be considered as a requirement to execute all trades under one unique law. More specifically use of French FBF contracts should be accepted if compliant with the rule book of a CCP.

#### **III.3 Public register**

#### **III.4 Access to a trading venue**

#### **III.5 Non financial counterparties:**

The existence of a threshold for foreign exchange derivative contracts prompts a question about the degree of inclusion of FX transactions within the scope of EMIR. If spot transactions are clearly

out of scope and if options are clearly within the scope some uncertainty remains on forward transactions embedding a currency swap. It is of prime importance that international standards apply in this matter and EMIR and Dodd Frank should converge for the sake of fair international competition.

### **III.6 Risk mitigation for OTC derivative contracts not cleared by a CCP:**

ESMA took into consideration the remarks expressed by the profession to extend the delay for confirmation of non cleared contracts. "Confirmation" is defined in annex V on page 138 of the Paper as "the moment when the full terms of the contract and any relevant master agreement are agreed between both counterparties to the contract" be introduced in annex 2. In practice, "confirmation" is materialized by the exchange of e-mail or fax mentioning all terms of the derivative which has been negotiated. There will be a necessity to add reference to contractual context and specifically master agreement to be compliant as it is not a common practice today. The exchange of fax or e-mail takes usually place within a couple of hours of the negotiation over the telephone, even if the signature of the paper documents will obviously be achieved days or weeks later. Thus a "confirmation" on the same day, except for late trading or time lag, seems possible. However Amundi suggests that the definition of "confirmation" as it appears in Annex V be transferred to Annex II.

When describing the confirmation process (p 73, Chapter VIII, article 1, item 2) the mention "where available via electronic means" suggests an obligation to use electronic means as soon as they exist. It seems advisable to delete that phrase which might be misleading. What was meant is more likely a general statement that a better process includes the use of electronic means. Incidentally, the fact that the use of electronic means would imply a reduced delay for confirmation was rightly deleted from the proposed regulation.

The number of pending contracts for a daily or weekly reconciliation and applying for other thresholds relates to contracts between counterparties, which means a fund (and not the asset manager in the case of Amundi) and a specific counterparty irrespective of the capital links that exist between different entities of the same group. The inclusion of such a comment in a rationale would be helpful for clarification.

Article 5 refers to circumstances under which valuation will move from a marked to market to a marked to model approach. Its wording in very general terms is not a concern for an asset manager who is daily confronted with valuation issues. Amundi insists that regulators should take a coherent approach between requirements for valuation of a derivative with a view to compute a NAV and in order to determine margin calls and adjust collateral. For example, under AIFM Directive an asset manager is required to refer to market prices, which might be produced by the counterparty for OTC derivatives, and challenges them by an independent valuation, generally based on internal models.

Intra group exemption has not much relevance for an asset manager as portfolios are independent entities, except for mandates where the final client is the counterparty. However if the negotiation of derivative contracts is centralized for practical reasons (expertise, legal documentation, counterparty risk management...) it is clear that the transaction initiated by a fund and contracted for by a subsidiary or a department of the management company with an outside counterparty is a pure back to back transaction in the books of this intermediary interposed between the fund and the market counterparty: it does not create specific risk and could benefit from the intra group exemption.

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#### **IV. CCP REQUIREMENTS:**

##### **IV.1 College**

##### **IV.2 Recognition of a CCP:**

The usual two principles that prevail in international affairs should apply when recognising third country's CCPs: equivalence of regulation and surveillance on one hand and reciprocity in terms of recognition of a European CCP abroad on the other hand.

##### **IV.3 Organisational requirements:**

The key point of stakeholders participation in CCP's Governance is commented in rationale 134 (p26) but concludes to the absence of regulation on the topic. Amundi believes that there are many issues in the organisation of a CCP where interests of end users, i.e. investors, and clearing members are not convergent, not to say they are conflicting. For example the balance to be reached between default fund and initial margin is very critical in that respect. Thus, it would be advisable for the regulator to demand that end users have a say not only in the risk committee but also at the Board.

Amundi agrees with the global approach inspiring the risk management provisions as they appear in article 2. It points especially out the comprehensive view of relevant risks and their interdependencies (as mentioned in item 2) and the necessity to demonstrate that procyclical effects are suitably limited (item 7).

##### **IV.4 Record keeping**

##### **IV.5 Business continuity:**

The attention brought to communication in a period of crisis appears to be of prime importance to avoid rumours and have a credible account of the situation.

##### **IV.6 Margins:**

If Amundi does not disagree with the approach taking as look back period the average of two 6 months periods, it finds difficult to accept the proposed 99.5% confidence interval suggested for OTC derivatives and the 2 and 5 day liquidation periods. The presumption that OTC derivatives are more illiquid and riskier than other ones is not true, for many OTC derivatives are very actively traded, especially those which will meet the criteria to be centrally cleared. Anybody may find listed derivatives that are far less liquid than OTC vanilla contracts that will be the bulk of centrally cleared OTC derivatives. This evidence leads to the conclusion that the criterion of differentiation based on OTC versus listed contracts is not appropriate to determine confidence interval and liquidation periods. Amundi suggests that there should be for the confidence interval only one minimum requirement of 99%, level that appears in the text of EMIR and in the consultation on "margin requirements for non-centrally-cleared derivatives" conducted by IOSCO and the Basel Committee. As far as liquidation periods are concerned the same idea of a single uniform minimum period established at 2 days seems acceptable, even if one may argue that many transactions can be liquidated within one day.

Furthermore, ESMA should reconsider its very restrictive view with regard to offsetting risks when portfolio margining: 80% offset limited to 70% minimum correlations is rather demanding and not adapted to, for example, the same proxy hedging that was accepted for Non Financials. Especially so if one does not overlook the requirement, justified as there is no provision for mutualisation of split default fund, that contracts should be covered by the same default fund to offset.

The article 5 is an anti procyclicality provision that we totally agree with. Amundi thinks that among the keys to solve that issue there is the need to greatly diversify the eligible collateral (and include

funds to the list) and to manage progressive changes in haircuts instead of abruptly exit one issuer from the list of eligible collateral.

#### **IV.7 Default fund**

#### **IV.8 Liquidity risk controls**

#### **IV.9 Default waterfall:**

The discussion about the level of the default fund, although interesting and wise, misses a key point: the fact that CCPs are authorized to split the fund in separate sub funds. Thus, the proper approach should be to identify both capital needs and default fund on the basis of each fragment of the total activity of the CCP instead of having a common global view. Amundi finds that it is now time to determine with certainty whether capital and default fund are totally available as “skin in the game” or should be considered as elements of different “games”. Financial stability resulting from CCPs capital structure is directly threatened by the current uncertainty on the level of mutualisation, if any, of these two components of CCP’s steadiness.

#### **IV.10 Collateral requirements:**

Collateral is designed to allow an alternative to cash deposit for both initial margin and default fund contributions. It is highly questionable that the default fund should not be deposited in cash in the hands of the CCP, then fully available without delay nor procedure and totally controlled in terms of risk and investments.

Amundi reiterates its view that the larger the eligible collateral the lower the market impact and the lower the procyclicality. This implies however an adequate policy of haircuts and a strict monitoring of market conditions to act immediately, but progressively, through higher level of haircut and not discontinuously through a ban from the eligibility list.

More specifically Amundi is happy that financial instruments are eligible under certain conditions (of risk and liquidity) meaning that a portfolio holding shares only might be able to provide appropriate collateral. Funds, UCITS or AIFs should also be eligible. The inclusion of covered bonds within the list of eligible collateral is another positive move. But the ban of real estate companies seems too severe as it stigmatises a type of companies on conjuncture’s and not structure’s considerations.

Amundi insists that funds shares or stakes be accepted as collateral if the fund invests only in instruments that are themselves individually accepted as collateral. The level of haircut for the fund would be the highest applicable to any instrument the fund may invest in. Using funds as collateral helps dealing with concentration and liquidity issues about collateral and indirectly procyclicality.

When assessing concentration limits in article 4, item 4, p 115 the proposed draft mentions money market funds in the list of instruments included in the total exposition on an issuer and its group. This sounds absurd to a fund manager as funds are independent entities and are constitutive of an exposure only on a look-through approach or in the case of a guarantee. A proper wording should be “funds benefitting from a guarantee and CNAV MMFs if implicitly guaranteed by the promoter”. The current wording is not acceptable.

#### **IV.11 Investment policy:**

The risks of the investment policy of a CCP should be accounted for in the level of required capital on the basis of the most aggressive possibility. The absence of any reference to credit ratings in the proposed draft is perceived as a positive step.

As an asset manager, Amundi suggests that funds presenting all the required characteristics in terms of level of credit risk and duration such as Money market funds or short term denominated bond funds should be eligible for investment by the CCPs.

When discussing in article 2 the “highly secured arrangements for the deposit of financial instruments” one may wonder why there is no provision to prevent the CCP belonging to a financial group to use as depository or custodian a bank of the same financial group.

Amundi considers that direct access of the CCP to the Central Bank for deposit and refinancing facilities is the utmost of security and should be promoted.

#### **IV.12 Review of models, stress testing and back testing**

The last article (15 SBT p 126) is of great significance as the public should be totally aware of the default procedures of each CCP. The way it would cope with a default should not leave room for interpretation and last minute decisions, under pressure. As members of the public, end users should be able to assess the quality of these procedures prior to establishing direct contact with a CCP.

#### **V. TRADE REPOSITORIES:**

Amundi stresses the necessity to converge towards a common (or at least highly comparable) type of reporting on both sides of the Atlantic. As G20 is an international initiative, a common approach worldwide should be achieved at least for what concerns the reporting obligation. Furthermore, a review of other existing reportings (under MIF for example) should be conducted to try and harmonize the requirements.

The publication of statistics (at an aggregate level only) could be extended from open positions to related collateral posted and volumes of daily transactions for better information of the public.

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