29 July 2011

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RE: Response to Principles for Financial Market Infrastructures Consultative Report

Dear Secretariats:

The Global Financial Markets Association[1] (GFMA) appreciates the opportunity to provide comments on the March 2011 Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) consultative report on principles for financial market infrastructures (FMIs). GFMA applauds CPSS and IOSCO for its consideration of these important issues.

We fully support the response to this consultation by the International Swaps and Derivatives Association, Inc. (ISDA). While ISDA has focused on the requirement as foreseen by the G20 for central counterparties to play a greater role in clearing derivatives, GFMA has concentrated its comments on those FMIs responsible for the clearing and settlement of cash securities.

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[1] The Global Financial Markets Association (GFMA) joins together some of the world's largest financial trade associations to develop strategies for global policy issues in the financial markets, and promote coordinated advocacy efforts. The member trade associations count the world's largest financial markets participants as their members. GFMA currently has three members: the Association for Financial Markets in Europe (AFME), the Asia Securities Industry & Financial Markets Association (ASIFMA), and, in North America, the Securities Industry and Financial Markets Association (SIFMA).

Key Points of Our Consultation Response

- We believe that the **application of the principles to individual FMIs** should be differentiated in relation to the specific type of FMI in the text covering principles, key considerations and explanatory notes. The matrix in Annex D may need to be reviewed as a consequence. In our view the **balance of safety and efficiency set forth** in the proposed principles merits careful attention. While we agree with the focus of the principles of safety and soundness of the FMIs, we note that efficient FMIs contribute to the orderly functioning of markets.

- We advocate a differentiated approach **to indirect / tiered participation** as outlined in the comments on Principle 19 (Tiered Participation Arrangements).

- In our view **coordination** of the timeline of the CPSS-IOSCO principles with relevant regulatory initiatives, such as the Dodd-Frank Act in the US and EMIR and the CSD legislation in Europe is required to avoid any material discrepancies.

- In regard of the planned **implementation date** of the CPSS-IOSCO principles, at end 2012, we recognise that this complements the G20 target date. However, we believe that the quality of the implementation process should prevail over the date of the conclusion of such process.

- Our view on **Governance** is that in order to manage conflicts of interest and preserve the integrity of the **CCP** in its role as a systemic piece of market infrastructure, the Risk Committee of the CCP should only be composed of Clearing Members who are risk mutualisers, i.e. they are willing to bear the risk of default by contributing their own resources to the CCP's default fund ("skin in the game") and are committed to participate in the default management process (dependent on the asset class that is centrally cleared). However, we recognise that both independents and non-risk-mutualisers can play a meaningful role in other aspects of the governance of CCPs, particularly through their board membership in these organisations.

- We believe that **all CSDs should be SSSs**, and that CPSS-IOSCO should make this explicit within the document at point 1.12 (p8) and in its glossary definition (p137), and highlighted in the text where relevant.

- We would like the definition of CSDs to include **ICSDs** for their CSD-type function. This should be explicit in point 1.11 (p8) and the glossary (p137), and highlighted in the text where relevant.

Principle 4: Credit Risk

We fully support CPSS-IOSCO's determination to ensure that FMIs effectively manage their credit risk. We have the following comments and suggestions:

a. *P30: "Stress scenarios …should include, but not limited to, the default of the [one/two] Participant[s] and [its/their] affiliates that would potentially cause the largest aggregate credit exposure[s] in extreme but plausible market conditions."*

We agree that participants should post sufficient margin to cover under different stress scenarios, including under extreme but plausible market conditions, potential losses. The default fund provides, via multalised resources, cover against any default modelling variances. The risk management framework needs to be more quantifiably determined, in collaboration with CCP Risk Committee's, such that each participant posts enough margin to cover the loss on default under extreme but plausible market conditions, which would need to take into account risk considerations such as product liquidity, market movements, concentration risk, wrong way risk, size and heterogeneity of the risk members present to clearing, size and heterogeneity of the risk their largest clients (simultaneously defaulting) present to clearing. In addition, the very extreme stress scenarios appropriate to the cleared product, the liquidation period and strategy as laid out in the default management plan and other equally important risk variables in determining the direct participant's margin or default fund requirements need to be considered. Here we should like to endorse ISDA's comments on credit risk as a one-size fits all approach may not be optimal depending on the type of FMI and the asset class provided for. We would like CPSS-IOSCO to carry out or commission and publish a detailed impact analysis, considering different scenarios by asset class/instrument and type of FMI, to help the market understand and agree on an appropriate basis for considering these impacts in a consistent way.

In principle the default fund should be designed to be adequate to manage a default situation. We note that the impact on members may vary according to the FMI's management of the waterfall and/or whether or not the FMI has a segregated default fund, the quality of clearing members and the asset class that is being centrally cleared. Should a CCP operate a single cross-instrument default fund we believe that in a default the risks should be properly allocated to the relevant clearing house members, i.e. the default waterfall should be allocated by instrument type. We suggest that CPSS-IOSCO should investigate the pros and cons of specific waterfall allocation and/or single default funds per instrument.

b. *P30, "A CCP should also maintain additional financial resources to cover a wide range of potential stress scenarios…"*

This point is covered in more detail in Principle 15, but we note that for a CCP the quality of its membership and the strength of its membership criteria/qualifications for membership, both at the point of joining a CCP and as an ongoing process of monitoring of the members, is its first line of defence.

Consideration needs to be given to concentration risk, which should be explicitly managed through the existing mechanisms of margin calls and membership criteria. .

c. *P31, Key consideration 3 (CSD/SSS management of exposures)*

CSDs and SSSs[2] should not incur credit risk within the entity that operates these core functions. It is our opinion that if they engage in any risk-taking activities they should do so within a ring-fenced structure subject to the same banking provisions as any other provider of banking services.

d. *P31, Key considerations 4 & 5 (99% initial margin/one or two participants and stress testing)*

We note that this requirement cross-references with Principle 6.

We would highlight that these key considerations only offer protection under the restricted context in which customers (i.e. indirect participants) bear the risk of a clearing member default, and clearing members post sufficient collateral to account for customer risk. If this is not the case then it runs counter to the defaulter pays principle, defeats segregation and can impede portability.

As highlighted above, CCPs need to model risk exposure under the principle of extreme and plausible market conditions such that margin covers losses under stress scenarios.

On the question of whether the default of one or two participants should be considered within the stress testing, we suggest that further modelling should be conducted to determine the levels required. As this is unlikely to be equivalent in

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[2] We have stated as a principle that we believe that all SSSs should be CSDs.

every possible scenario, we believe that setting a minimum is the most useful way of addressing this point.

e. P31-32, 3.4.1 (Credit risk)

Final sentence: we believe it is not only the design, but the structure and practices of an FMI that have impact, and suggest that you add these two words to the end of that sentence, to read 'The type and level of exposure faced by an FMI will vary based on its design**, structure and practices**.'

We would also add that we believe that FMIs should be obliged to publish details of their credit risk management measures, algorithms, data parameters and processes to their members, and demonstrate to the appropriate authorities that their monitoring is sufficient and effective.

f. P32, 3.4.2 – 3.4.5 (Credit risk in payment systems, CSDs and SSSs)

We think that the principles within this section should be strengthened. It is our firm belief that mitigation is the first line of defence, and there is a strong need to minimise credit risk in payment systems and SSSs. We suggest that for CSDs and SSSs paragraphs 3.4.2 (Source of credit risk) and 3.4.4 (Mitigating credit risk) are strengthened in line with our comments stated in Principle 12, as this will significantly reduce their need for emergency liquidity.

In an emergency CSDs or SSSs will need to be in a position to cover any committed liquidity, and will need liquidity agreements in place to achieve this, either through access to Central Bank Money or via an adequate committed credit line from a commercial bank.

We note that CSDs should have the highest possible settlement efficiency. If a CSD does offer credit (overdraft facilities) it should do so on non-commercial terms, i.e. terms that make it unattractive to participants and therefore do not impact settlement efficiency.

g. P33-34, 3.4.6 (Credit risk in CCPs)

We support the comments in this paragraph. With reference to the last sentence '*A CCP can also face potential future exposure due to the potential for assets posted as margin to decline significantly in value over the close-out period*.' To manage this risk more effectively risk margin needs to be extremely liquid, i.e. it should be cash and / or eligible collateral subject to the appropriate pre-disclosed haircuts. The CCP should consider the liquidity that might be needed to manage a close-out over a reasonable period, appropriate to and dependent on instrument type.

h. P34, 3.4.7 (Measuring and monitoring credit risk)

We agree that '*future exposure is typically more challenging to measure…*' and note that this also depends on the individual CCP's profile and the instruments it covers.

i. P34, 3.4.8 (Mitigating credit risk)

'*A CCP may choose to place limits on collateralised exposure in some cases*.' We agree, see point g. above.

j. P34, 3.4.9 (Managing credit risk)

We support these comments.

k. P34, 3.4.10 (Financial resources)

We support these comments, but note that modelling and impact analysis needs to be undertaken to determine the level of 'tail risk' to be covered.

l. P35-36, 3.4.11-14 (Backtesting, Stress testing)

We support these sections.

m. P36, 3.4.15 (Use of financial resources)

We support the comments on FMIs not considering resources required for operational activities as 'available' to cover losses. We note that very close attention is required to the structure of the FMI, its rules and membership criteria, its close-out arrangements and liquidity provisions, all of which should be approved and publicly available.

n. P37, 3.4.16 (Contingency planning for uncovered credit losses)

We support these comments, and note that this refers back to our previous comments about liquidity provision.

Principle 5: Collateral

We realise that the intention of the overall principle is to specify inter alia that collateral should be highly liquid and thereby have low liquidity risk, and suggest that the wording could be strengthened to ensure no room for ambiguity or misunderstanding.

In general we endorse this principle, with a few comments.

a. *P37, Key Consideration 5 (Cross-border collateral)*

We do not understand what is meant by cross-border collateral, nor the risk perceived, and would appreciate clarification in order to comment; or that this section should be removed as not relevant..

b. *P38, 3.5.1 (Value of collateral in liquidation)*

In the event of liquidation it is important that an FMI does not exacerbate the situation by imposing an unnecessarily restrictive time limit that would effectively force a fire-sale. The FMI should also not be permitted to block any more collateral than it can demonstrate is required for the specific default.

c. *P38, 3.5.2 (Acceptable collateral)*

We fully support the principle that '*participants should not be allowed to post their own debt or equity securities, nor bonds or equity of companies closely linked to them as collateral*.' We are also supportive of efforts to manage wrong-way risk, although it is difficult to see how better this can be managed than through the already established processes of membership rules and strict collateral eligibility. Managing such risk is an intrinsic part of risk and stress management, and we would expect any additional concentration risk (e.g. in the case of a sovereign crisis) to be managed by additional calls for collateral; and that collateral quality would be measured and monitored and more stringent haircutting of existing collateral imposed where relevant.

d. *P38-39, (Avoiding concentration of collateral)*

We support these comments. Note that it is critical that clients know they will be able to get their assets back in the case of the default of the FMI. This reinforces our earlier comment that the FMI should only lock up collateral needed to liquidate the positions in a default, whether of a participant or the FMI itself. FMIs should be obliged to offer their participants the means to ring fence their assets from the FMI's default (see also Principle 40).

It would also be helpful if CPSS-IOSCO could address what would happen in a situation where a FMI participant not permitted by local regulation to pledge its collateral (e.g. central banks, pensions funds) goes into default.

e. P 39, 3.5.6 (Cross-border collateral)

We do not understand the situation being described in the first 10 lines of this section, and cannot see what problem is being addressed. Please clarify so that we can comment in detail. We fully endorse the rest of the section, beginning '*An FMI also should consider foreign-exchange risk…*" and suggest, pending clarification, that this section be limited to this part only.

f. P39-40, 3.5.7 (Collateral management systems)

We fully endorse this section, and would add to the final sentence the provision that the staff of the FMI must be suitably qualified to perform these tasks.

We note also that it is possible for the collateral management function to be outsourced. Should this be the case, we believe that conditions should be imposed: the quality, expertise and sophistication of the provider must be proved, any reuse of collateral should be transparent to members through the rules, and the provision of this function should be separate from any core function services.

Principle 6: Margin

a. P 40, the Principle and key considerations 1 & 2

We agree with the principle as stated but believe that specific reference should also be made to the protection required for clients' margin against the default of the FMI itself. We refer to the BIS consultation document, *Capitalisation of bank exposures to central counterparties,* of December 2010, paragraphs 115 and 116.

We fully support key considerations 1 and 2.

b. P 40, Key consideration 3

See our comments on p31, Key consideration 4, above.

c. P42, 3.6.4 – 3.6.5 (Price information)

We agree with the comments in 3.6.4 and support them as workable in the current situation. However, it is not clear that exactly the same provisions will work for non-centrally cleared instruments, and suggest that further work needs to be done on this. We disagree with the statements in 3.6.5 that although independent sources would be '*preferable*' participant sources may be '*sufficient*'. We do not believe that a single participant is ever a sufficient source of price data for a clearable instrument; independent sources and independent price verification is always essential and should be among the requirements for making an instrument clearable.

We believe that eligible collateral should at least be highly liquid with a minimal credit risk. We also see the benefit of a minimum cash threshold and concentration limits by instrument to ensure available liquidity at the CCP should a clearing member default.

d. P42-43, 3.6.6 – 3.6.8 (Initial margin methodology)

The default of the FMI itself should be considered in stress-test scenarios.

We disagree with the flexibility of the language in section 3.6.8. The principle should be established that CCPs **must** disclose and make transparent to its participants all of these data. We suggest that the words 'as possible' in line 4 and 'Ideally' in line 7 should be deleted, and that 'would' should be changed to 'should' in line 7.

e. P43, 3.6.9 (Wrong-way risk)

We fully support and endorse the comments on wrong-way risk.

f. P44-45, 3.6.13(Cross-margining)

We think it would be helpful to define the requirements for the segregation of participant collateral from the FMI's estate in the event of an FMI default.

g. P46, 3.6.16(Timeliness and possession of margin payment)

We agree with this principle, and would request the addition of a principle that should a CCP find it has over-collateralised, then such collateral should either be returned promptly to the participant, or if applicable, in line with any Standing Order Procedure.

Principle 7: Liquidity Risk

a. *P46, the Principle*

We refer to our earlier comments on the method to be considered in a stress scenario.

b. *P46-47, Key considerations*

We would like FMIs to be required both to conduct detailed scenario planning and to publish the results to their participants, including giving clarity on what the FMI will do about liquidity provision in the case of default.

c. *P48, 3.7.4 (Measuring and monitoring liquidity risk)*

We endorse this point. It should include the requirement for CSDs that provide banking facilities to stress test their management of overdrafts, i.e. they should manage and monitor their overnight liquidity and credit activity and should stress test any changes in the ratio of intra-day versus overnight liquidity. They should also be required to provide tools that help participants improve settlement efficiency. As mentioned elsewhere in the document, we would suggest that ancillary and core services are segregated to avoid contagion risk

d. *P 49, Managing liquidity risk*

We would like FMIs to verify what liquidity they will commit in a stress situation; provisions should be put in place and the details published to participants.

e. *P 49, 3.7.8 (Maintaining sufficient liquidity reserves)*

On the requirement on CCPs and CSDs to have sufficient liquidity to effect business in the case of default of certain participants, we refer to our previous response at Key Consideration 4.5 p31, where we suggest that modelling should be conducted to determine the right level of requirement.

f. *P50, 3.7.11 & 3.7.12 (Central bank services)*

We note that most CSDs have access to Central Bank Money and rely exclusively on this facility; most central banks extend liquidity to the designated settlement banks for the CSD, not the CSD itself. Many CSDs therefore do not have arrangements to access alternative private-sector liquidity. We would like to understand the impact on the CSD of a central bank deciding not to extend credit to major market participants.

We are concerned that the two paragraphs are somewhat unclear and contradictory, on the one hand suggesting that FMIs should not rely on central bank money and on the other that they should utilise central bank money wherever available. We would like to understand whether FMIs can count on central bank liquidity or not.

Principle 8: Settlement Finality

We believe that this principle provides a good minimum standard. We suggest that CPSS-IOSCO could consider adding an aspirational target of settling intra-day or real time, rather than stating this as a preference.

a. *P53, 3.8.2 (Final settlement)*

We strongly urge CPSS-IOSCO to make a statement about the desirability of reaching global agreement on the definition of settlement finality. This is particularly necessary for the smooth operation of cross-border business.

b. *P54, 3.8.6 (Revocation of transfer instructions)*

It is helpful to formalise the process of revocation of transfer instructions, and we believe that it is necessary to have a single approach. However, in the event of insolvency or default we do not believe it is reasonable to expect settlement parties to effectively underwrite the market. Please refer to Principle 13 for more detail.

Principle 9: Money Settlements

We fully support this Principle. Central Bank Money (CeBM) is preferable where available but it should not be mandated in all cases.

For transactions where CeBM could be used (e.g. in the domestic CSD, when the participant has access to CeBM) there should not be deterrents to using it. It should be understood that participants may not have access to CeBM and will work via an intermediary which does. This intermediary could be another CSD participant or the CSD operating an ancillary service outside the core CSD services.

a. *P 55, 3.9.3 (Commercial bank money)*

FMIs should be reminded to monitor the ratio of internal versus external settlement requirements. This is relevant to liquidity requirements; with a higher external settlement rate liquidity requirements will increase.

b. *P 56, 3.9.6 (Settlement on the books of an FMI)*

With reference to the notion of *'supervised special purpose institution'* and note 71. We recommend the removal of the words 'may be' from the requirement to hold banking licenses. If an FMI is conducting banking activities it should be subject to all relevant existing banking requirements (e.g. Basel III). We do not believe there is any requirement for a new, special kind of license to cover such activities when performed by an FMI.

Principle 10: Physical Deliveries

We note that this section is mostly focused on commodities, which is not our area of expertise. However, on the general principle, we would suggest adding wording in two areas:

- Add a requirement for an FMI to have within its rules a standard of care and liability to its participants
- Add a requirement for an FMI to state clearly which asset classes are accepted within their service, and to demonstrate formal processes and risk assessment criteria specific to each one.

a. *P58, Central securities depositories and exchange-of-value settlement systems*

We endorse this principle, but acknowledge the necessary exception for securities that are privately held or not publicly traded. In general, securities should be dematerialised or immobilised at the CSD wherever possible and should only be rematerialised in exceptional circumstances.

Principle 11: Central Securities Depositories

a. *P58, The Principle*

We believe that this principle should also apply to ICSDs, and that they should either be explicitly alluded to here, or included within the CSD definition in the glossary to the document on p137.

Please delete the word 'help' in the first sentence, and also the similar wording in the glossary on p137. However, only CSDs that are Issuer CSDs can accept responsibility for the integrity of an issue. This is a core function and Issuer CSDs must therefore be **required** to ensure the integrity and minimise and manage the listed risks. The regulator should monitor that they do so.

b. P58, Key considerations

1. We suggest changing the word '*appropriate*' in the first sentence to '*adequate*'.

5. We believe that CSDs' ancillary functions should be separated from their core functions to avoid contagion risk, and would therefore suggest amending the wording to allow for this – we suggest inserting '*and alternative structures*' after the phrase '*additional tools'*.

c. P60, 3.11.4 (Immobilisation and dematerialisation)

We suggest inserting the phrase '*supported by law'* at the end of the sentence following note 78. We also suggest inserting '*or a change in law*' at the end of the final sentence.

d. P60, 3.11.5 (Segregation of assets)

We fully support the segregation proposals. However, use of the segregation facilities should not be mandatory but subject to user choice, in consultation with the users' underlying clients. Segregation by beneficial owner is not a protection against custody risk; there are other tools which provide this within omnibus account structures.

Prohibiting intermediated (omnibus) holding structures is an impediment for the development of a cross border market. Omnibus account structures facilitate end investors' access to markets at reasonable cost.

We believe that the word '*transfer*' would be clearer than the word '*portability*' in the sentence that refers to movement of client assets in a default.

In the final sentence, we think that a CSD *should* have insurance, not '*consider*' it. We also think that there should be defined standards of liability, and that the phrase '*and define standards of liability*' should be added to the end of the final sentence.

e. P60-61, 3.11.6 (Other activities)

We believe that there should be legal separation of the ancillary activities of a CSD. We therefore suggest replacing the word '*or*' in the second last line on p60 with the word '*and*.'

On page 61, we strongly disagree with the material on a CSD acting as principal. It is our firm belief that any such activity should be separate from the core functions of a CSD, and that a CSD should not, for example, take principal risk on a securities lending transaction. Risk taking activities need to be ring fenced.

f. P61, 3.11.7 (Other activities)

We agree in general with this principle. However, the final sentence is a poor example with which to illustrate the point and we suggest deleting this material. CSDs do not assist CCPs with their liquidity; the reverse may be true.

Principle 12: Exchange-of-Value Settlement Systems

We agree with this principle. We would suggest pushing the aspiration higher, and suggest inserting a requirement that markets should strive for consistency; and the simultaneous fulfilment of their obligations, i.e. Model 1 (or at least Model 2), and we would like to see CPSS-IOSCO making a more definitive statement on the three models it defined in its document *Delivery versus payment in securities systems* of September 1992. We also suggest improving the definition of DVP in the glossary at p137 to include the notion of simultaneity, and the aspiration to move towards Model 1/RTGS where there are clear risk benefits and supporting cost-benefit analysis. Some markets may already achieve the cited risk management processes and a move to RTGS would not provide additional benefits versus the market adaptation cost and timelines.

a. P62, 3.12.3(Gross or net settlement obligations)

For the markets that do not already achieve the cited risk management processes we referenced in the opening paragraph, our view is that end of day settlement is higher risk and inefficient. We suggest tightening up the process described: settlement cycles several times during the day is less risky than deferring everything to the end of the day. A tighter process will also help to minimise any delay between the settlement of cash and securities.

b. P62-63, 3.12.4 (Timing of settlement)

We disagree with the second sentence: our view is that true DVP is simultaneous, and that this should be the aspiration of these principles that all markets should be striving towards, i.e. Model 1.

We agree that blocking is a reasonable remedy, but it is not perfect.

Principle 13: Participant Default Rules and Procedures

a. P64, 3.13.6 (Public disclosure)

We believe that the replenishment processes and margin multipliers should be included in the transparency requirements for FMIs. Participants should be given the full picture so that they can be prepared (e.g. if there is likely to be a requirement for additional margin calls participants should be forewarned).

Principle 14: Segregation and Portability

As a general comment, we think it is important for CCPs and their regulators to consider the different risk profiles and requirements for the clearing of different instruments, and that this concept of considering different instruments should be worked into the principles.

a. P66, Key consideration 2

It is important to emphasise customer choice in this context: the facility should be provided, and customers should be able to decide, in consultation with their clients, which facilities they will make use of.

b. P66, 3.14.1 & 3.14.2 (Explanatory notes)

Transfer of collateral cannot take place without simultaneous transfer of the positions, and vice versa. If an omnibus account is held, then in a default everything would be transferred. Where positions are fully segregated, the client does not have the risk cover usually provided by the GCM; the client is at risk to the CCP instead and must therefore cover the capital risk it now has against the CCP for itself.

c. P67, 3.14.5 (Customer Accounts)

We fully support footnote 90 which states that in some cases "domestic law enables segregation and portability by alternative means." In order to give this point sufficient emphasis, we propose that the entire footnote is promoted into the body of the Consultative Report.

d. P67-68, 3.14.6

We fully endorse the principle that customer and proprietary accounts of the participant should be fully segregated on the books and records of the FMI.

e. P68, 3.14.7

We believe that it is the GCM, not the CCP that must maintain the customer records. CCPs are not in a position to obtain or maintain this data; the client relationship is between the CCP participant and his client.

f. P69, 3.14.12 (Transfer of positions and collateral)

We generally agree with and endorse this principle. However, we believe it is important to state that positions should not be forcibly imposed upon other participants.

Principle 15: General Business Risk

We agree with the introduction of the additional risk dimension 'general business risk' and the related principle and key considerations.

Given the systemically important nature of FMIs we deem the additional globally harmonised capital requirements equal to six months of operating expenses as a minimum. This amount should be reviewed on a regular basis and should be measured against criteria including type and complexity of product serviced.

Principle 16: Custody and Investment Risk

We agree with the principle; however, we deem a clarification of the applicability to individual FMIs and types of assets (own assets, assets posted by participants) indispensable.

For example, in the case of CSDs, SSSs and payment systems, we believe that there should only be custody and safekeeping of the assets deposited by the participant with no possibility for the FMI to invest these assets.

For FMIs that are CCPs, the investment of participants' assets (Key consideration 3 and explanatory note 3.16.4) needs to be appropriately risk managed. Where this is permitted, an FMI should only invest its assets in very highly liquid resources through mechanisms that have been stress tested to ensure that those assets are available at value in a timely manner under extreme circumstances. The primary objective of the investment policy should be to minimise interest rate, credit risk and investment risk, in addition to providing sufficient liquidity.

Firstly, there should be clarity in the CCP's rules about whether the CCP is entitled to use and invest the participants' assets.

Secondly, there should be a distinction between such assets posted by participants in the form of cash, easily fungible and reinvestable, versus securities and other forms of collateral postings, in which case reinvestment would require adequate rehypothecation rules and possibly conflict with the protection and safety of clients' assets.

Thirdly, if the CCP is indeed authorized to make investments using the participants' assets, then in line 4 of note 3.16.4 we would like to add that the overall investment strategy should be fully disclosed and approved by the CCP's risk committee.

Principle 17: Operational Risk

We agree with the principle and the key considerations.

In our view the operational risk management should be made transparent by FMIs to their members.

In regard of minimum operational requirements for participants (3.17.17) any duplication of regulatory standards should be avoided as participants would in most cases be subject to regulation such as banking regulation; moreover such minimum operational requirements should be proportionate to risk.

Principle 18: Access and Participation Requirements

We welcome the overall principle that such access should be non-discriminatory at FMI, participant and asset class level. However, the risk that lowering capital requirements, and requiring only that member cleared risk be proportional to available capital, will require CCPs to better understand the risks a participant runs on a daily basis, so as to have confidence that the participant will be able to meet capital calls (daily pre-funding of client margin, intra-day margin, assessment obligations etc.) under extreme but plausible market conditions. This problem is further confounded if a participant is a member of more than one CCP. While we welcome the open access principle, we recommend that CCPs put safety first, as the principle explicitly suggests.

We endorse these principles and believe they should all also explicitly apply to inter-FMI links. There should be fair and open criteria for FMIs to link to one another.

a. *P81, Key considerations*

1. We support these principles of fair and open access, including reasonably risk managed links between FMIs.

2. As a member of an FMI the risk is mutualised amongst the FMI and its participants. We therefore request the insertion of the phrase '*and existing participants'* after '*in terms of safety and efficiency to the FMI'*.

b. *P82, 3.18.5 (Risk-based participation requirements)*

Whilst we agree in general with this paragraph, we believe that the requirement should be clearly restricted to covering risk to the FMI and participants *in the FMI*. Where you suggest that 'it may be appropriate for the FMI to impose additional requirements' we would add the proviso that it should not substitute for regulatory and supervisory requirements where they either exist or require introduction. The FMI should never act as a substitute for the supervisor or regulator.

c. *P83, 3.18.6 (Participation requirements)*

Participation requirements are an important element of risk management for the FMI, and should therefore be subject to agreed criteria approved by the FMI's risk committee. It is important to guard against discrimination in this context: we question the use of the word '*unduly*' in this paragraph (second sentence) and suggest its removal. It is especially important to guard against discrimination on the basis of nationality or location of the participant. The reference to local laws and policies should be amended to refer only to local laws as being an acceptable constraint.

d. P83-84, 3.18.8 (Monitoring)

Whilst we agree that an FMI needs to be able to monitor its participants to ensure adherence to the rules and standards of the FMI, we are not comfortable with language that suggests an FMI should act in place of or as a regulator or supervisor. We suggest rewording the phrase on line 3 of p84 from '*an FMI should have the authority*' to '*an FMI should ensure its rules enable it*'. At the end of the same sentence we suggest the insertion of the phrase "*for example where a participant exceeds certain activity thresholds*."

Principle 19: Tiered Participation Arrangements

For purposes of the application of Principle 19 we recommend that the Principles draw a distinction between the different types of FMI's, such as CSD and ICSDs on one hand and CCPs on the other. These distinctions are rendered necessary by virtue of the specific characteristics and role in the financial system of these different types of FMIs.

For CSDs and ICSDs who provide settlement and custody services, there are usually several levels of holders behind the direct participants. This is the case in particular for custodial activity. In those cases, in our view it would not be beneficial to the stability of the financial system to identify and track the various levels of the holding chain behind the direct participant. For these reasons, we do not recommend to introduce a requirement to track indirect participants in CSDs and ICSDs.

With respect to CCPs, depending on the segregation model, CCPs have direct access to information relating to the positions and margin of a client accessing the CCP indirectly through a clearing member. This information should be used for risk management and margining purposes, but should not amount to a full due diligence by the CCP or even a right of refusal of the client. The Clearing Member remains responsible towards the CCP for the activity of its clients.

We believe that it would be helpful to include definitions of your terms Direct participant; Indirect participant; and Tiered in the document's Glossary.

a. P85, 3.19.5 (Managing credit and liquidity risks of indirect participants)

We would like to see Sponsorship arrangements being specifically covered in this section. In the case of Sponsorship arrangements the roles, responsibilities and obligations of each party should be clearly explained and made transparent to all parties affected, i.e. all participants within the FMI.

b. P86, 3.19.6 (Indirect participant default procedures)

Direct participants should accept principal risk when they have signed up to do so. In the event of the default of an Indirect participant this can only be enforced if it is within the rules of the CCP. The rules to be imposed in this regard should be clearly and explicitly defined. It should also be made clear that CSD participants should not be placed in a situation where they are guaranteeing settlement, i.e. acting as a CCP.

c. P86, 3.19.8 (Limiting indirect participation)

Although you refer to Principle 18, it seems clear that Principle 18 does not apply to Indirect participants. There are no access criteria for Indirect participants, since they are not direct clients of the FMI. For these provisions to apply to them they would need to become Direct participants. It is unclear what you expect FMIs to do in this regard.

Principle 20: FMI Links

We fully support this principle, in particular item 3 in the Key considerations (that linked CSDs should measure, monitor and manage their risks arising from one another).

We would note in general that the risks addressed here should be considered as a matrix, not simply a series of horizontal lines between FMIs performing services in the same service layer (i.e. not only CSD-CSD and CCP-CCP). The same risk management criteria should be applied between layers (e.g. CCP-CSD; Exchange-CSD): all of the requirements should be applied between all FMIs and it should be made explicit that they do apply.

a. P87, Key consideration 7

We believe the requirement to identify, assess and manage collective risk agreements' risks should apply regardless of how many links there are. If you have identified exponentially greater risks of three or more links then it would be helpful if you could be more explicit about this and apply more stringent criteria in this case.

b. P87, Key consideration 8

We do not believe that this requirement is sufficient; 'at least on a daily basis' should be changed to 'intra-day'.

c. P89, 3.20.6 (CSD-CSD links)

We have a clear preference for settlement in Central Bank Money wherever possible to avoid credit risk between CSDs. We also question how any credit extensions between CSDs would be effected and covered? Where would the collateral, given that CSDs do not have any, come from?

d. P90, 3.20.10 (CCP-CCP links)

We support CCP links (interoperability) for cash securities central clearing at the current time, which should preferably be peer-to-peer; we do not want to see CCPs acting as participants of one another as this would introduce unacceptable levels of risk. CCP interoperability is in its infancy. Regulation on interoperability should therefore be reviewed at adequate intervals.

e. *P90, 3.20.11*

We applaud this principle and its clear expression of good risk management within a level playing field.

f. P91, 3.20.13 & 3.20.15

We disagree with the final sentence of paragraph 3.20.13 and the first sentence of paragraph 3.20.15. These imply that all links are not subject to the same standard of risk criteria when it is clear to us that they should be. Links between FMIs should adhere to at least the same criteria and standards as for Direct participants.

g. P91. 3.20.14

Risk management should not be confidential; FMIs should be required to publish their criteria for FMI links, and any resulting link agreements should be published to participants. Any additional risk management criteria introduced should also be published.

h. *P91-92, 3.20.17*

FMIs should not be competing on the basis of risk management standards. Their risk management arrangements, whether in house or for FMI links should be subject to regulatory approval.

Please see also our previous comment on Key consideration 7 related to the point on 'three or more'.

Principle 23: Disclosure of Rules and Key Procedures

We fully support this principle, and particularly appreciate the requirements of paragraph 3.23.2.

We would suggest that in addition to the disclosure requirements already included, there should be a requirement for FMIs to publish their risk calculation model (i.e. their risk algorithm) to their members, as requested.

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We hope these comments are helpful. We appreciate the opportunity to participate in the discussion about FMIs. Should you have any questions, please do not hesitate to contact us.

Respectfully submitted,

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