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EUROPEAN SAVINGS BANKS GROUP
GROUPEMENT EUROPEEN DES CAISSES D'EPARGNE
UROPÄISCHE SPARKASSENVEREINIGUNG

EUROPEAN ASSOCIATION OF COOPERATIVE BANKS
GROUPEMENT EUROPEEN DES BANQUES COOPERATIVES
EUROPÄISCHE VEREINIGUNG DER GENOSSENSCHAFTSBANKEN

DM/MT
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Brussels, 28 September 2012

Subject: ***TARGET Working Group Response to the CPSS/IOSCO Consultative Report on Recovery and Resolution of Financial Market Infrastructures***

Dear Sir/Madam,

The TARGET Working Group (TWG) would like to thank CPSS and IOSCO for the opportunity to comment on the above report. The TWG represents the European payments industry in discussions with the ECB/Eurosystem on issues relating to the TARGET 2 payment system. Consequently, remarks in this note are restricted to payment systems which are referred to whenever the term FMI is used. No comment is offered in relation to other types of FMIs.

Our remarks are divided into two sections.

- general remarks
- detailed comments on the report

General remarks

1) Whilst the unique nature of FMIs is implied in the report, it is not entirely clear whether the authors believe that continuity of FMI services should be the overriding objective or whether they envisage more of a parallel with resolution of a financial institution in difficulties. It is strongly recommended that the report states clearly that continuity of FMI services should be the overriding objective with the various resolution procedures described being an option for achieving this.

2) Having said this, we broadly agree with the comment in the covering note that all types of FMIs should generally be subject to regimes and strategies for recovery and resolution. However, a significant number of FMIs, particularly RTGS payment systems, are owned and operated by central banks but we have been informed by the European Central Bank that CB owned FMIs are expected to be exempt from the recovery and resolution requirements. If this is correct, we

believe it is important that it is made clear in publicly available documentation and also that Note 2 in the Consultative Report is amended accordingly.

It is recognised that whilst like any other corporate body, privately owned FMIs will be subject to applicable insolvency and associated legal provisions, such provisions may not be applicable to public authorities including central banks. Nevertheless, an FMI owned and operated by a central bank could encounter a serious problem arising from, for example, fraud or a legally binding court order against it or even serious operational problems. However, it is not clear how it is envisaged such a problem would be resolved for a CB owned and operated FMI. Bearing in mind the need to preserve the continuity of the FMI's critical operations and services and to minimise systemic disruption (see also section 4.6), it is suggested that resolution of issues affecting CB owned and operated FMIs, which may be addressed by resolution procedures in the case of privately owned FMIs, should be clarified in the report.

Another issue which we believe would benefit from clarification is the public authority/central bank owner of an FMI also being the resolution authority for competing private FMIs, or at least having a substantive role in that process. We recognise that a similar situation can arise with regard to oversight but nevertheless believe it should be addressed formally in this report.

3) Even in the case of sovereign default of the country in which a payment system is located, a central bank operating a payment system using the currency of its own country would normally still be able to function and operate domestic payment systems. However, in such circumstances, the CB should also be required to provide local currency to facilitate the operation of privately owned FMIs. For the purpose of this paper war, armed hostilities or major civil unrest which prevent the operation of key infrastructure including payment systems has been ignored. Conversely, a factor which can affect both publicly and privately owned payment systems is where they are either not using the currency of the country in which they are located or are possibly using a currency shared with other countries. In such a case, it is likely that privately owned systems would still be subject to applicable resolution procedures. However, although a central bank owned system may still exist, it would no longer necessarily be in a position to provide an effective service. In such circumstances it is not clear what powers could be given to the relevant authorities in order to maintain a payment system's critical services necessary to maintain stability.

4) With one important exception we believe the summary of the KAs provided in the annex is sufficiently detailed to support the development of recovery and resolution regimes for FMIs. The exception relates to FMIs operated by central banks where further clarification on how they should be interpreted would be welcome. Subject to the opt-outs recognised by the Commentary, we consider that all the KAs may be applicable to all types of FMIs although in practice the degree of applicability will differ.

5) It is undoubtedly true that resolution and recovery will be much easier if an FMI's obligations and liabilities are unambiguous and not subject to the possibility of dispute. In this connection, it is considered to be particularly important that an FMI's responsibilities under tiered participation arrangements (see Principle 19) are clearly stated and, where appropriate, backed by legally binding contracts whether by means of adherence to the FMI's rules or a separate contract.

Other questions raised in the covering note are, where appropriate, addressed in the detailed comments below.

Detailed comments on the report

2.2/3 Whilst liquidity shortfalls are mentioned, these appear to be in the context of external events affecting the FMI. However, such shortfall can also arise as a result of an FMI suffering a technical failure which results in liquidity becoming trapped in the system and unavailable for use in a back-up or contingency system pending restoration of the primary system. In such circumstances participants will not necessarily have sufficient spare liquidity outside the affected system. Consequently, it is suggested that all FMIs should plan for such an eventuality as opposed to relying on ad hoc measures if it happens. This is considered to be increasingly important if high quality and liquid collateral are likely to be in short supply.

2.8 Clarification is requested on whether, and if so how, it is envisaged that this provision will be applied to central banks operating FMIs.

3.4 It is assumed that for this purpose "capital resources" includes "loss absorbing financial resources" as described in Note 134 to the underlying Principles. However, it is considered important that such resources are dedicated to a specific FMI and double duty avoided.

3.7 In answer to the two questions following paragraph 3.7:-

- in general statutory management, administration or conservatorship would appear more suited to private sector FMIs. However, the key issue is considered to be less the type of FMI than whether the administrator or similar official is enabled to maintain critical functions of the FMI under applicable law.
- The answer to "powers required" is likely to depend on the detailed insolvency/bankruptcy provisions of applicable law in the jurisdiction concerned.

3.14 The questions following this paragraph appear to relate principally to CCPs, hence no comment is offered.

3.18 The questions following this paragraph again seem to relate principally to CCPs, so no comment is offered.

3.21 In answer to the three questions following this paragraph:-

- as illustrated, it is recognised that it may not be desirable for equity, or a similar asset type, to be written down in all circumstances. Consequently, it is suggested that dependent on applicable insolvency law, FMIs should be structured to seek to avoid undesirable consequences arising from resolution procedures.
- There may be a case for loss allocation in resolution to result in a different distribution of losses borne in insolvency if this enables critical services to be maintained in the interest of the community as a whole. However, this will depend on the circumstances of each individual FMI. How the loss is incurred is considered to be of less relevance than seeking to maintain critical services which are considered to be essential to the wider economy.
- It is suggested that consideration of an FMI's rules for addressing uncovered losses should be taken into account to the extent that they illustrate the parties' intentions. However, care must be taken to ensure the legal validity of FMI rules is not compromised.

3.23 In the case of payment systems, the applicability of the two questions following this paragraph is limited and it seems sensible to address the issue by restricting any termination rights as part of the rules of the system, possibly with an override clause for use at the discretion of the FMI.

4.8 In response to the two questions following paragraph 4.8:-

- Whilst it is difficult to envisage circumstances where suspension of payments to unsecured creditors would facilitate an FMI's clearing operations and ensure settlement, it would not seem sensible to prohibit the option.
- It seems sensible to allow resolution authorities limited discretion to apply a moratorium if doing so is judged to reduce systemic risk.

4.14 In answer to the question following paragraph 4.14, in the case of payment systems we would suggest that participants which had deposited such unutilised funds should have first claim on them and take priority over settlement of the FMI's own obligations.

4.22 We do not understand why financial intermediation and transactional banking should necessarily mutualise exposures. Surely, this depends on the underlying contractual structure. Clarification is requested.

4.22 In answer to the question following paragraph 4.22, it is not considered that such wider loss recovery arrangements would normally be appropriate for payment systems.

4.26 In answer to the question following paragraph 4.26, it is suggested that the overriding factor should be maintenance of clearing operations critical to the wider economy and mitigation of systemic risk.

Annex 4.1 We agree with the need for the legal framework to be clear, transparent and enforceable but wonder if it would assist clarity to cross reference to the Explanatory note to Principle 1: Legal basis with particular reference to section 3.1.3 on legal opinions/analyses.

We hope you will find these comments useful and shall be happy to address any supplementary questions.

Please address any queries to Ms Denisa Mularova (e-mail: d.mularova@ebf-fbe.eu).

Yours sincerely,

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TARGET Working Group

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