COMMENTS BY THE BANCO DE LA REPUBLICA (CENTRAL BANK OF COLOMBIA) ON THE PROPOSED PRINCIPLES FOR FINANCIAL MARKET INFRASTRUCTURES

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Banco de la Republica (BR) –the Central Bank of Colombia- has organized several meetings with the interested parties in the analysis and discussion of the consultative report on the Principles for Financial Market Infrastructures (PFMI) prepared by the CPSS and the technical committee of IOSCO, among which: 1) the technical staff of the payments systems division at BR, 2) the Payment Systems Committee (which is led by the BR and has representatives of all the domestic financial market infrastructures -SIPS, CSD / SSS, CCP, FX clearing house (CH), etc-, financial institutions such as banks, securities firms and others and regulatory and supervisory authorities such as the Financial Superintendence and the Central Bank). The results of previous rounds of discussions were also communicated to the Directive Board of the BR.

The first section of the comments presented herein corresponds to general remarks on the Report as included in the current consultative version. The second section includes comments on specific Principles. In some cases a particular reference is made to comments received from domestic FMIs that do not necessarily reflect BR´s opinions but that BR has agreed with the originator(s) to transmit to CPSS- IOSCO.

I. General Remarks

- All interested parties found the Report on the PFMI very serviceable, relevant and well oriented. The new Principles are indeed a step forward in relation to current standards and incorporate a significant number of lessons drawn from the recent global financial crisis. The inclusion of an assessment methodology will be very useful to better gauge how to undertake self-assessments and as a tool for the authorities´ oversight function.

- The report itself is quite long and repetitive. Many ideas, discussions and recommendations reappear several times given the links and crossed references between Principles. A shorter and smoother drafting could be envisaged (for instance by referring in each Principle to a related idea in another one without repeating similar texts or discussions).

- There are concerns on being able to fully comply with those the Principles that “raise-the-bar” in a short timeframe. Granting an adequate timeframe for requiring full compliance might be a mechanism to alleviate the burden.

- Some Colombian FMIs consider that their risk models cover stress scenarios that allow them to withstand the failure of the two largest participants. Some others, however, advocate for establishing just a “cover one” requirement, due to the exponential costs associated higher standards in emerging economies whose financial and capital markets are not so deep and do not play a systemic role in the global economy.

- The Report states that an FMI is interconnected to its participants, other FMIs, and other parties and should therefore ensure that its framework for the comprehensive management of risks includes the identification and management of risk associated with any such interdependencies. Supervising and overseeing the implementation of this framework and assessing its effectiveness are in the opinion of the WGPS-LAC precisely what in the post-crisis jargon is called a “macro prudential tool” for assessing systemic risk. It would be welcome therefore that the report more clearly illustrates what a macro-prudential tool is, what serves it to and helps raise awareness on that it may complement other macro-prudential tools being already used or being recommended to contribute to financial stability. The use of this complementary macro prudential tool might be a responsibility of central banks and other public authorities

- For countries where it is not mandatory to clear and settle OTC derivatives through central counterparties, some more specific standards on clearing and settlement arrangements for OTC derivatives would be useful.

- In emerging and relatively less developed financial markets it would be difficult to avoid some degree of collateral concentration, especially in certain types of government securities and references.

II. Comments on specific Principles

- **PFMI 1**: There is no full clarity on where and when to define “finality” in cross-border operations between interconnected infrastructures and “who gives title” (see also PFMI 8). Not all the countries have a clear definition in their domestic legal framework either about where and when finality takes place , who gives title to the investor and how to protect the securities and payment cycle when a chain of transfer agents, custodians, registrars and possible others and exchange-of-value settlement systems are involved in a transaction.

A possible criterion for that purpose that in our opinion may reduce uncertainty is to consider that finality is reached when the payer’s account is debited and the beneficiary´s account at the SIPS (CB) is credited and title is given on the securities side as soon as entry is booked on the SSS systems (since from that moment on securities and cash can immediately be used)

There is a case for discussing the consequences of precautionary judicial decisions /interim orders that may affect commercial banks´ accounts at the CB (whose effects may be devastating for financial stability); myopic judicial decisions based on private interests and commercial law considerations may cause liquidity systemic risks.

Deceval, the Colombian private CSD/SSS has requested us to transmit the comment that in their opinion there is not enough clarity in the report on corporate actions and the protections of rights derived from them (also likely related with PFMI 11)

- **PFMI 4**: The PFMI seems to support transparency in segregating own account and individual customers positions of direct participants in FMI. Only a few countries in the world, among which Colombia and Brazil, require their CSD, CCP and FX clearing house (CH) to fully segregate individual customers´ accounts. This seems to be a "best practice" according to the Report PFMI´s approach that should be more clearly advocated since it would be instrumental for the Hague Convention discussions on this matter.

Deceval has also requested us to transmit the comment that in their opinion payments and delivery reversals on corporate action could impose major credit risk on CSDs and SSS. There is the need in their opinion to have protocols in corporate actions whereby payments and deliveries are done on a DVP, DVD or PVP basis.

- **PFMI 9**: There is broad agreement among our FMI in that settling in CB money is clearly the best practice and that the use of private money for settlement is a second best.

From the link between PFMI 7, 8, 9 and 13, Colombian private FMI consider that there is a case for discussing in more depth whether systemically important FMI could have access to CB accounts in order to make finality more reliable and for efficiency considerations since biggest market participants also have accounts at the CB. Direct debit orders on their participants´ accounts while simultaneously crediting the FMI account at the CB would therefore speed up and increase soundness in the settlement process.

Furthermore, they commented that it would be interesting that the Report illustrates in more detail the current state of the international discussions on the pros and cons of FMIs access to CB liquidity facilities in times of market stress.

- **FMI 11**: A consensus emerged in advocating a stronger case for dematerialization of securities. Doing business on deeper capital markets and on a global basis necessitates the dematerialization of securities, since managing the processing of transactions in a physical environment is highly impractical and inefficient.

- **PFMI 15**: we recommend discussing whether or not supervisory authorities should allow a FMI to extend its activities to new areas of business if the new activities risk undermining its core focus, capital or financial soundness.

- **PFMI 17**: It is important to emphasize that the concern with operational risk is not only at the level of individual FMIs but also of the financial sector as a whole. Authorities should therefore encourage operators and participants to cooperate in collective efforts to test if interconnectivity between FMIs works smoothly and that time recovery standards are met not only by individual FMIs but also for interconnections between all relevant domestic and cross-border infrastructures, as well as with other related parties (including banks, transfer agents, registrar and others involved in the value chain).

- **PFMI 22**: It is suggested that issuers inform relevant FMIs of all corporate actions using a standardized format.