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Euroclear response to the consultation by CPSS and IOSCO on Principles for Market Infrastructures

This response is provided on behalf of the Euroclear group of companies ("Euroclear"). Euroclear comprises the international central securities depository ("ICSD") Euroclear Bank ("EB"), based in Brussels, as well as the national central securities depositories ("CSDs") Euroclear Belgium ("EBe"), Euroclear France ("EF"), Euroclear Nederland ("ENL"), Euroclear UK & Ireland Limited ("EUI"), Euroclear Finland ("EFi"), and Euroclear Sweden ("ES"). It also includes Xtrakter, a provider of trade matching and transaction reporting services based in the UK.

We welcome the consultation by CPSS and IOSCO and appreciate the possibility to provide comments on these thoroughly reviewed principles. We applaud the extensive work that has been performed by the CPSS and IOSCO task force, and hope that our comments will find their way into the final set of principles applicable to CSDs and SSSs.

Our response is divided into the following sections

1. General remarks
2. Comments on the proposed Principles

As a member of the European Central Securities Depositaries Association (ECSDA) we share the comments made by this Association in its separate consultation response.

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I. General remarks

Principles should better reflect the different dynamics and characteristics of CCPs and CSDs

We understand the desire to increase (strongly) the safety standards of FMIs, but we would like to caution against "copy-pasting" principles and key considerations that, while valid for CCPs, are not appropriate for CSDs. We would like to point out the following:

- First, risk taking is at the core of the value proposition of CCPs, not of CSDs. CCPs interpose themselves between the counterparties to a financial transaction and therefore assume credit, market and liquidity risks. In contrast, the credit and liquidity risks borne by CSDs are a side effect of their activity.
- Secondly, in the aftermath of the crisis, many policy actions have been taken, or are planned, to encourage or mandate the use of CCPs. This will make CCPs even more systemically important in the future, which justifies an increased focus on their continued safety. There has been no regulatory demand to increase the use of CSDs. There is no reason to believe therefore, that CSDs will become more systemically important than they are today. While we absolutely agree that CSDs should carry high standards of risk mitigation, we believe that some of the proposals on credit, liquidity and collateral (which are particularly relevant for CCPs) either do not seem directly relevant to CSDs, or are too strict or prescriptive for CSDs.
- Thirdly, many of the services offered by CSDs (settlement, safekeeping, corporate action processing, etc) are also performed by other financial actors. Putting too stringent standards on CSDs may therefore, lead to a situation where such activity moves from CSDs to financial intermediaries that are not (and should not) be regulated as FMIs. *As the Principles now follow an institutional and no longer a functional approach, we propose that a new general remark is inserted into the Principles urging regulators and supervisors to collect information on the importance of the FMI-type activities performed by no-FMI so that necessary transparency is created.*

For the above reasons, we believe it is justified that some of the Principles distinguish more clearly between standards for CCPs and CSDs**.** This is specifically the case for the following Principles which we believe are too much CCP-oriented, both in content and in wording: Principle 5 Collateral, Principle 7 Liquidity, Principle 9 Money Settlement, and Principle 19 Tiered Participation arrangements. This is explained in more detail in section II below.

As a more practical comment, we would suggest that the final Principles should (also) be available by type of FMI, not just as a combined set of Principles.

Principles should preserve level playing field

We note the specific questions in the Cover note to the consultative report with regard to Principles 4 and 7 and the stress test scenarios on credit and liquidity risk respectively. While we can understand that there could be a need to differentiate between the scenarios ("cover one" or "cover two") depending on the specific profile of the CSD, we want to stress that the implementation of different scenarios could lead to level playing field concerns. We therefore suggest either to define one particular scenario applicable to all CSDs, or to implement the same scenario for CSDs that represent "similar" profiles which would be determined by the respective regulators. In the latter case, there could be a role for IOSCO and CPSS to determine what constitutes a "similar" CSD profile and for ensuring transparency on the scenarios followed by FMIs worldwide. In the EU, such role could be taken on by ESMA and the ESCB.

Relation between CPSS/IOSCO Principles, ESCB/CESR recommendations and EU CSD Regulation needs clarification

As EU-based CSDs, we are particularly interested to understand how the new CPSS/IOSCO Principles will fit into the overall legal and regulatory framework for EU CSDs. It is our view that the new Principles should be integrated into such framework rather than being a separate set of principles CSDs would need to comply with. The better solution would be that the upcoming EU CSD Regulation forms the basis for the regulatory framework for CSDs and that the more detailed standards are established by ESMA and ESCB, based upon the globally agreed CPSS/IOSCO principles. In such scenario, the current ESCB/CESR Recommendations for Securities Settlement Systems would be superseded by the above.

As the Principles are much more prescriptive than current CPSS/IOSCO, and even the ESCB/CESR recommendations, we would like to have clarification on how FMIs will be assessed against the Principles, the Key Consideration and the Explanatory notes. Such clarification should also help to ensure a coherent application of the Principles across FMIs/CSDs. We believe that the generally increased requirements might call for a longer implementation period.

The distinction between CSDs and SSSs does not seem warranted

It is not clear to us why the Principles make a distinction between CSDs and SSSs, as mostly these will be the same legal entities. We believe this complexity is not required. Should certain rules only be applicable to CSDs or SSSs, this could be made clear in the text of the Principles.

The link between the Principles and EU banking regulation and the EU crisis prevention and resolution framework should be clarified

Some FMIs (such as the ICSDs) are established as credit institutions and therefore need to comply with all relevant banking regulation such as the EU Capital Requirements Directive, and the upcoming EU regime for bank crisis management, recovery and resolution.

We believe that there should be a general recognition in the Principles that FMIs' compliance with relevant banking rules also represent compliance with (parts of) the relevant Principles. This should avoid unnecessary regulatory and administrative burden for those FMIs. This is specifically the case for Principles 3, 4, 5, 7, 13, 15, 17.

FMIs' responsibilities for risks related to interdependencies should be aligned with their ability to control such risks

We agree that FMIs have a high level of responsibility for protecting the market against systemic risk. This is fully justified where systemic risk might be caused by deficiencies in the functioning of the FMI itself (or where the FMI could take steps to prevent systemic risk issues impacting participants in its own systems). We are concerned however, that the Principles seem to require that FMIs need to fully *control* all the risks arising from interdependencies with and between FMIs, related infrastructures or with market participants. Specifically with regard to market participants, we believe this is not realistically achievable. Market infrastructures do not possess the means nor the tools to *control* their participants or other stakeholders in the complex chains of processes and interactions involved in the securities business. They can not be held accountable for contagion impacts beyond their control. This is more a topic where regulators would be better placed to lead the initiative to achieve such financial stability objectives. We would welcome further dialogue on this issue with CPSS-IOSCO.

For example, requiring FMIs to test and review periodically their participant default procedures together with their participants is close to impossible. FMIs do not have the leverage to impose such tests on their participants and neither the FMI nor the participants would wish to share all information relevant for conducting meaningful tests (in particular information on individual participant transactions should remain confidential). If ever such tests need to be considered, regulators would be best placed to take responsibility for their coordination and to guarantee the confidentiality of the required information.

As there are important limitations preventing FMIs from monitoring and controlling all externalities, we believe it is more reasonable and realistic to expect an FMI to *understand* the risks arising from the interdependencies on which it has a direct view, and where possible, to mitigate the role such interdependencies might play in transmitting shocks. FMIs already contribute today to mitigating systemic risks. By offering DVP mechanisms, CSDs generally ensure that credit or liquidity shocks cannot be propagated among their participants. Where Euroclear Bank is aware of (and able to control the risks arising from) interdependencies, it takes the necessary steps to do so. This is the case for example in relation to the management of the Bridge between Euroclear Bank and Clearstream Banking Luxembourg. We expect regulators to play an important role both in supporting the FMI in these tasks and in ensuring cooperation between relevant regulatory bodies.

The Principle on tiered participation arrangements is too far-reaching for CSDs

We do not believe that this Principle should be applicable to CSDs. We fail to see why and how a CSD could gather basic information about indirect participants and could monitor and manage relevant concentrations and interdependencies. Nor is it clear what the CSDs would do with such information (assuming that it could actually be collected).

First, it seems more a task for the regulators of the CSDs' direct participants (that are regulated entities) since it is the regulators that have the knowledge of underlying customers and can identify concentrations and interdependencies. Assessment of underlying client concentrations and interdependencies requires knowledge of the full extent of an entities business, far beyond a CSD's settlement related information. CSDs do not have regulatory powers.

Secondly, there might be confidentiality concerns from the CSDs' direct participants which might not want to reveal data to the CSD about their underlying customers.

We believe this topic merits a more detailed analysis to which we are ready to contribute.

Risks incurred by FMIs themselves and by their participants

We believe that the Principles should distinguish more clearly between the risks that are faced by the FMIs themselves, and those that are faced by market participants or the market at large, and which the FMI might be able to alleviate (e.g. settlement risk through DVP). The confusion is particularly strong in the Principle on "Custody and investment risk" which, in addition, aggregates different risk types already covered in other paragraphs (e.g., operational risk elements related to the sub-custody of participant securities or securities belonging to the infrastructure's portfolio and financial risks related by the infrastructure's investments).

Even for CSDs that do not incur credit and liquidity risks, the text of the related Principles appears confused about the role of a CSD in the management of these risks (which are taken and managed by settlement banks).

Definition of CSDs and related functions and services

We believe the Principles should not try to come up with exact definitions of a CSD and the functions it performs, but rather be open and flexible enough to allow adaptation to specific CSDs and markets. Specifically at EU level, there is a wide variety of CSDs and the functions they perform. For example, not all EU CSDs have a direct relationship with the issuer of securities, not all EU CSDs perform the function of ensuring the integrity of securities issues, and not all CSDs perform safekeeping services, etc. We therefore, suggest leaving the flexibility to national or EU regulators to designate the entities that qualify as CSDs in their territory, at least until such time as the proposed CSD legislation is implemented (since this legislation should define a CSD precisely).

Assessment of compliance with market wide recommendations (Annex C)

We understand that these recommendations have not been subject to review but would like to understand how the compliance with these recommendations will be assessed once the Principles are in place. As these recommendations are generally addressed to the market as a whole, we assume that the relevant supervisory authorities would perform the assessment for their territory.

II. Comments on the Proposed Principles

Principle 1: Legal basis

The principle requires that "the rules, procedures and contracts related to the operation of an FMI should be enforceable under all relevant jurisdictions" (3.1.9).

We think the wording of this principle should be clarified, particularly in relation to the understanding of "default rules and procedures" and "relevant jurisdiction", in order to make compliance realistic. More specifically, the operating rules of a European CSD will detail how the systems operator would handle instructions from a participant in default. These rules will link to, and be supported by, the EU Settlement Finality Directive (SFD) as implemented in the local law of the jurisdiction where the CSD is located. The very purpose of such legislation is to "overrule" the potential effects of bankruptcy legislation so as to ensure the soundness of the systems operations. Ensuring the enforceability of such processing rules in all participant jurisdictions will in practice amount to asking the CSD to export the SFD to all participant jurisdiction. This is not possible, nor is it necessary. We believe this concern could be addressed by clarifying that default rules and procedures are meant to cover collateral arrangements involving the FMI, but do not include the operating rules of an CSD.

Principle 2: Governance

3.2.3. We are not sure what is meant by "performance accountability" and would appreciate some clarification.

3.2.10. We believe that the *"and"* should be replaced by *"or"* in the phrase "internal controls and related procedures should be subject to regular review and testing by well-trained and staffed risk-management *and* internal audit functions". Institutions may have different arrangements in place that ensure adequate review and testing, and duplicating such work would not bring additional benefits.

3.2.11. We agree with the requirement for the Board to be involved in key risk management decisions, and that the Board should approve the risk management framework. However, we do not believe that all elements listed in this paragraph require Board-level decision. This is the case for new products (most of which do not materially affect the risk profile of the entity) and most FMI links. A reasonable threshold of materiality should be set in respect of both the novelty of the product or service and its implied risks. Board approval might also not be appropriate for large individual credit exposures. We agree however, that the Board needs to be informed of any material exceptions with regard to the agreed framework.

Principle 3: Framework for comprehensive management of risks

KC3. We do not believe that it is possible for CSDs to make a comprehensive assessment of the risks they *pose to* other entities, or to fully capture the risks related to interdependencies with other entities.

The assessment of risks caused by a CSD or by the interdependencies between CSDs and other FMIs, requires very close cooperation between relevant regulators or supervisors (who should take the responsibility and the lead in such matters).

Footnote 29: Real-time information is certainly desirable for the market and for the CSD itself, but today such information is rarely available. This is only achievable for processes carried out by the CSD itself. Where information needs to be obtained from external providers, the CSD is dependent on such providers and can thus not be expected to provide real-time information to its participants. Supervisors and overseers might consider requiring other market participants to provide more frequent or even real-time information to CSDs and other FMIs.

3.3.6. As mentioned above, we believe a CSD cannot be expected to control fully all of the risks related to interdependencies, as it does not have access to all relevant information, and is not in a position to monitor and mitigate all such risks. Where its risk management tools might allow a CSD to alleviate risks related to interdependencies, the CSD should use such tools to the fullest extent possible. We want to stress that imposing on CSDs very strict risk management controls and mitigation might lead (as an unintended impact) to business moving to non-FMI-type entities which are not (and should not be) subject to FMI Principles. This could eventually even lead to an increase in, rather than a decrease of, systemic risk.

3.3.7. We believe pre-implementation reviews and advice on internal controls should preferably be provided by Risk Management to ensure that Internal Audit retains an independent view when conducting an assessment. The text could be amended to read *"involve their risk management or internal audit function in pre-implementation reviews".*

Principle 4: Credit risk

This Principle should more clearly recognise that not all FMIs incur credit risk on participants, or in their processes. Most CSDs (where they settle in central bank money) face only very limited credit risks, related to the management of their own funds and/or of the capital they hold to comply with the relevant regulatory requirements. For some CSDs, such risks are matters for their participants and settlement banks to monitor and manage.

KC3. For CSDs, we believe that the notion of 'future credit exposure' is not relevant. First, because the exposure is always very short term (intraday exposure) and rarely extends beyond two working days. Secondly, the uncertainty related to the value of collateral posted to cover intraday credit should be appropriately covered by the valuation and conservative haircut that is applied to the collateral (see also Principle 5).

KC7. Following the principle itself, we believe that this key consideration should only apply to CCPs. Otherwise, the content of this Key Consideration is richer than Principle 4 itself.

3.4.5 We agree that an FMI's credit exposures to its participants should be, to the greatest extent possible, secured. Securing such exposures can be achieved through cash or securities collateral or through commitments from other market participants. Equity capital should be the last resort. CSDs might however, not be in a position to request collateral from certain participants such as central banks (some of which might even not be allowed to pledge their assets by law). We believe that the CSD should be able to obtain exemptions to the collateralisation requirement for exposure to high-rated central banks, or to central banks that are not allowed to pledge their assets to the CSD.

We agree that any unsecured exposure to participants needs to be strictly limited and understand that such exposure would need to be limited in relation to the CSD's available equity capital. Along the lines explained above, we believe CSDs should be able to obtain an exemption to the requirement of setting aside capital for unsecured exposure for exposure certain central banks.

We believe footnote 36 on page 33 needs to be clarified. Specifically, "Such use of equity capital should be strictly limited to avoiding disruptions in settlement when *collateral cannot be available timely"*. As the equity capital is seen as a buffer against losses in unsecured exposure, we do not understand what the reference to collateral means.

In addition, we would like to stress that there are other measures to mitigate credit risk than just securities collateral. See also Principle 20.

3.4.15. This states that "an FMI should not consider as "available" to cover credit losses from participant default those resources that are needed to cover normal operations or operating losses, or to cover losses from other activities in which it is engaged". We agree that such resources should not be double-counted (which would be the case to cover different types of losses), as they cannot be used twice. But, it is unclear what is meant by "normal operations". For a CSD, this might cover intraday credit provision. However, in a severe market downturn, as might be caused by the failure of a major participant, it is very probable that the CSD would not provide the same level of credit as under normal circumstances. The CSD should therefore, be allowed to consider a lesser need for additional financial resources in case of a participant failure, provided it is capable of ensuring the continuity and adequate performance of its operations, and it would not cause undue systemic risks by excessively restricting credit provision to the market.

3.4.16. The right balance needs to be struck between transparency and disclosure of rules and procedures to participants, and the possibility to retain a sufficient margin of manoeuvre in case of a stress situation. In a scenario of stress, the FMI will need to determine its course of action based on a number of parameters such as market conditions, participants and market counterparties' behaviour, ease of access to the market, etc. This cannot always be prejudged and, in certain circumstances, too much transparency might be harmful for the FMI and for the market.

Principle 5: Collateral

The principle states that "an FMI that requires collateral to manage its or its participants' credit risk…". For a CSD, the Principle should only relate to the CSD's credit risk, not the credit risk of its participants.

We believe that the combination of all requirements in the Key Considerations of this Principle would put undue pressure on available collateral and collateral value, and does not recognise the relation between, on the one hand, limiting credit, liquidity and market risk and, on the other hand, ensuring such risks are adequately covered by collateral. Specifically, as currently stated, collateral should:

- involve low credit, liquidity and market risk, *AND*
- be valued prudently, *AND*
- be subject to conservative haircuts that are also stable to avoid pro-cyclicality, *AND*
- take into account concentration limits, *AND*
- take into account wrong-way risk.

This combination of requirements might in practice lead to a shortage of collateral for participants of CSDs, or to activity moving from CSDs onto the books of financial intermediaries, which are less demanding on collateral. We believe that the approach should recognise that participants in several CSDs may have competing needs for collateral. Moreover, restricting collateral eligibility is not the only way to control exposures. It might sometimes be desirable to have the possibility to extend the range of collateral eligible, while enforcing appropriate haircuts.

We also wish to point out that the use of stable haircuts to avoid pro-cyclicality is not sustainable in crisis situations.

As pointed out above, we believe there are other possible risk mitigants than collateral that can provide adequate credit risk protection for CSDs. These should be taken into account in this principle.

Principle 7: Liquidity risk

This Principle should recognise more clearly that not all FMIs incur liquidity risk. For some CSDs, such risks are matters for their participants and settlement banks to monitor and manage. Where FMIs already need to comply with banking regulations related to liquidity risk management, this should be explicitly recognised. From an EU perspective, we would appreciate reference to, and consistency with, the recommendations for liquidity risk management issued by the Committee of Banking Supervisors (CEBS) (which are based on the Basel Committee of Banking Supervision's principles for liquidity management and supervision).

With respect to the establishment of a minimum liquidity requirement and the related stress test scenarios, we believe that all CSDs should be subject to the same scenario (either the "cover one" or the

“cover two” scenario) for level playing field reasons. Any deviation from such a uniform rule should be made transparent between regulators and supervisors (and – at EU level - potentially ESMA or the ESCB).

Euroclear Bank has the possibility to re-use collateral obtained from a defaulting participant with immediate effect, thereby mitigating its liquidity risk in addition to the credit risk covered by the collateral itself. It does not therefore, as such object to considering the need to cover exposures resulting from the *two* largest participants. We stress however that such requirement should respect the level playing field with similar FMIs.

KC4. According to this consideration, an FMI should obtain a high degree of confidence through rigorous due diligence that each liquidity provider - whether or not it is a participant of the FMI - would have sufficient information to understand and to manage its associated liquidity risks, and that it has the capacity to perform as required under the liquidity arrangement. We believe that this consideration is only relevant for pre-arranged *committed* liquidity arrangements. This should be clarified.

3.7.1. While we agree with the intent of this consideration, we believe it should be adapted as the current wording seems to imply that an FMI is responsible for monitoring market wide liquidity management.

3.7.5. We believe that the requirement to “regularly assess each liquidity provider to see whether it is able to meet its respective same-day funding commitment” is only relevant for pre-arranged *committed* liquidity arrangements. This should be specified.

3.7.6. The statement that “an FMI should ensure that it is operationally ready to manage the liquidity risks caused by financial or operational problems with its participants or other entities” gives too much responsibility to a CSD. A CSD that does not provide banking services itself would not, for example, be able to manage the liquidity risks to its participants stemming from problems with a settlement bank. Some clarification would therefore be welcome, limiting the FMI’s responsibility to cases where its own actions, or the design of its infrastructure, would potentially cause liquidity risks to be transmitted to or among its participants.

3.7.10. Guarantees or letters of credit, if they are valid and enforceable, and provide for immediate provision of cash, should also be considered as available liquid resources in case of need. Admittedly, these resources are dedicated, i.e. would only become available in case of very specific events. We are not sure to understand “such committed lines of credit in themselves may be used as a source of liquidity, but may not be double-counted as liquid resources”.

3.7.14. We believe that the frequency of liquidity stress testing for CSDs might need to be different from that for CCPs.

Principle 8: Settlement finality

p. 52: In the introduction on *Settlement,* the risks borne by the CSD should be distinguished from those borne by its participants. Stating that "a key risk that the CSD *faces* is settlement risk" is generally incorrect, as the CSD itself tends to hold only very limited amounts of good quality assets (as part of its own securities portfolio) which are settled through DVP mechanisms on the books of other CSDs. This is certainly true for Euroclear Bank, which only invests in highly rated ESCB-eligible government bonds. It would be better to state that "A key risk *managed* by CSDs is settlement risk".

In addition, we believe a distinction needs to be made in relation to different FMIs for purposes of the requirements on "final settlement". Section 3.8.2 is based on the assumption that the participants enter into transactions with the FMI. While this is true for CCPs, it is not in our experience the case for the operator of an SSS. Within a securities settlement system, the rules defining finality are part of the general processing rules of the system, they describe a factual matter of what the system will do to settle transactions and at what moment all necessary conditions have been met. We do not see the value of obtaining a legal opinion on this specific, factual aspect of the rules.

3.8.3 It should be noted that same-day settlement can only be completed provided the participant has sufficient resources in its account, or sufficient collateral to cover its credit needs. The last sentence is confusing: it seems to refer to the settlement risks borne by the FMI on its own investments (in which case the risk is not that of a participant but of a counterparty default) – which would not, except if it threatened the CSD's own survival - lead to contagion effects towards its participants.

Principle 9: Money Settlement

This principle should distinguish more clearly between CCPs and CSDs. Indeed, the wording of this principle ("an FMI should conduct its money settlements in central bank money where practical and available") is clearly inspired by CCPs and does not fit easily for CSDs as "money" settlements seem to include both "clean payments" and payment obligations related to DvP securities settlement. We believe that for CSDs the wording should rather refer to the nature of the cash settlement asset in DVP settlements, in line with the previous CPSS/IOSCO Recommendation or ESCB/CESR Recommendation 9.

In addition, we would like to understand the link between Principle 9 which requests to "strictly control credit and liquidity risk arising from the use of commercial bank money" and the other Principles. In the current text, there is no reference to the need for the commercial bank money provider to be compliant with Principles 4, 5 and 7. We assume that such link should exist, just as it exists in the current Recommendations for SSSs where the Recommendation 10 on settlement assets requires that the provider of commercial bank money be compliant with Recommendation 9 on credit and liquidity risk. Otherwise, we would like to understand how supervisors will assess what it means to "strictly control credit and liquidity risk". At present, it seems as if different measures are required to strictly control credit and liquidity risk depending on whether it concerns CCP cash settlement or DvP securities settlement. This difference would need to be removed.

3.9.4: "A commercial settlement bank should be subject to effective banking supervision and regulation": this is certainly true, but the quality and effectiveness of such measures may vary from country to country, and the FMI remains dependent on such local expertise.

Principle 11: Central securities depositories

We would like to point out that not all CSDs have a direct relationship with securities issuers or maintain accounts for securities issuers. Moreover, not all CSDs can ensure the integrity of the securities issue as they do not possess all information to perform this task, mostly because this task is performed by other entities such as registrars or by the issuer itself. The Principle should recognise that there are differences in CSD models which mean that some responsibilities should not or cannot be taken on by CSDs.

KC1: we propose to amend the consideration as follows: "A CSD should have appropriate rules and procedures, …. to safeguard the interest of securities issuers *(where applicable)* and holders". Similar changes would need to occur in 3.11.1 and 3.11.2 reflecting the different nature of CSDs and their respective roles.

KC4. We do not believe it is a CSD's role to incentivise dematerialisation. This is a matter of government policy and market acceptance.

KC6 seems redundant given KC6 in Principle 17 on Operational risk and Principle 20 on FMI links.

3.11.2. In cases whereby the CSD is not the (only) entity that is involved in ensuring the integrity of securities issues, we believe that it is not only up to the CSD to ensure cooperation with the respective other entities (issuers, registrars, other intermediaries) but that the respective regulator and supervisor should put a corresponding responsibility on those other entities. Please note that the role of ensuring integrity of securities issues is in some markets entrusted to unregulated entities. In that case, the CSD cannot be assumed to take the required responsibilities.

Principle 12: Exchange-of-value settlement systems

3.12.5. This paragraph makes reference to the provision of DvP, DvD and PvP settlement by the FMI participant to its own customers. While we agree that such measures would be recommended, we would like to understand how regulators and supervisors would ensure such principle would be implemented, knowing that this would then apply to entities that are not FMIs.

Principle 13: Participant-default rules and procedures

3.13.2. We believe that the requirements set out in this paragraph are too detailed. In our experience, the range of default/contingency situations is too broad and involves too many possible permutations to specify in advance down to this level of detail.

3.13.5. “An FMI’s rules and procedures should indicate the circumstances when management can exercise discretion” is vague and could encompass many circumstances. More clarity seems required.

3.14.6. Public disclosure is not always desirable and, in some circumstances, might be harmful for FMIs and for the market. For example, some actions by the FMI which might be described in its default rules and procedures might also be appropriate in other circumstances. The market might however, interpret any reliance on such action as the reaction to a severe stress event, and starve the FMI of liquidity.

3.13.17. Requiring FMIs to test and review periodically its participant default procedures together with its participants is not realistically achievable. FMIs do not have the leverage to impose such tests on their participants and neither the FMI nor the participants would wish to share all information relevant for conducting meaningful tests (in particular information on individual participant transactions should remain confidential). The maturity levels of contingency procedures among FMIs and participants might also be very diverse, so that ‘one size fits all’ tests would be difficult to design. All these hurdles mean that, if ever such tests need to be considered, regulators would be best placed to take responsibility for their coordination and to guarantee the confidentiality of the provided information.

Principle 15: General business risk

KC2. We believe that the sentences “Resources held to cover potential general business losses should be in addition to resources held to cover participants default or other risks covered under financial resource principles” and the penultimate phrase in 3.15.6 contradict “capital held under international risk-based capital standards, however, may be included where relevant to avoid duplicative regulation”. We agree, of course, that capital requirements under Basel II / CRD should be taken into account, the more so as under Pillar 2 business risk needs to be accounted for.

Business risks faced by the CSDs are limited mainly to non-receipts of fees. Holding large amounts of capital to cover operational expenses over a longer time horizon than is currently the case seems redundant and imposes additional risks on the CSDs (as that cash is held with commercial banks and is therefore subject to credit risk). We believe that the Principles should not impose any greater requirements than those demanded by local regulators which we experience to be between 3 and 9 months of operating expenses.

We believe that the Principle should be sufficiently flexible to allow for support to be provided by the parent company in cases where the FMI forms part of a wider holding structure. For example, CSDs belonging to the Euroclear group could, in addition to their own resources, rely on the much larger resources of the group.

Principle 16: Custody and investment risk

3.16.2. “It is particularly important that assets held in custody are protected against claims of a custodian’s creditors”. While this can be enforced for securities, it cannot for cash, as cash is fungible and

is not segregated. It might therefore be recommended to make the distinction clear between securities and cash assets.

Principle 17: Operational risk

3.17.16 to 3.17.20. As mentioned before, understanding interdependencies is extremely complex, and a full understanding would require obtaining proprietary information that other relevant stakeholders have no incentive to disclose.

3.17.13. With respect to the secondary site: staffing should not be required, as working from another location (including home working) might be a possibility.

With regard to business continuity, we believe that some requirements seem too prescriptive. Some solutions might not be available or widely used yet (e.g. cloud computing), but could still achieve the main objectives. Redundancies are therefore not always the sole option for ensuring resilience. The Principles should be principles-based rather than rules-based; their current very high degree of detail might prevent FMIs from designing innovative solutions.

3.7.17. We believe it is not for the FMI to define operational and business continuity requirements for participants. FMIs are unlikely to have the necessary knowledge of the whole business activity of the participant, and may not have sufficient powers to gather such information and enforce requirements.

Principle 18: Access and participation requirements

This Principle only considers access of participants to an FMI but not access provisions related to the receipt of a transaction feed from trading platform or CCPs. We believe this element should also be considered.

Principle 19: Tiered Participation arrangements

As explained under the General Comments, we believe this Principle should not be applied to CSDs.

Principle 20: FMI links

This principle only deals with horizontal links between CSDs or between CCPs. As mentioned above, the matter of a CSD access to a transaction feed of a trading platform or a CCP is not covered. Yet, such access is an equally important matter that deserves attention by CPSS-IOSCO .

3.20.6. We believe that the current text "In addition, any credit extensions between CSDs should be cover fully by high-level collateral, and be subject to limits" should take into account the letters of credit that EB and Clearstream Banking Luxemburg (CBL) have arranged to cover their mutual exposures and which are seen to be a very valid risk mitigant. These letters of credit are a legally valid and enforceable agreement, involving more than one market counterparty, and are appropriate to cover the risks related

to the operation of the Bridge between EB and CBL. Such risks are related to the provision of intraday credit to ensure the smooth settlement of transactions across the Bridge. In addition, Footnote 22 should also refer to the letters of credit set up to cover the mutual exposures of EB and CBL as “other adequate collateral”.

Principle 23: Disclosure of rules and key procedures

We do not agree that all procedures should be fully disclosed. For example, we would not expect bilateral CSD-central bank procedures to be disclosed. This section might need to clarify the scope of procedures it thinks might benefit from being publicly available.