



Letter EPC120-11
Brussels, 29 July 2011

Via E-Mail

Mr. William C. Dudley
Chair, Committee on Payment and Settlement Systems
(cpss@bis.org)

cc: Mr. Peter Praet, ECB
Mrs. Daniela Russo, ECB
EPC Plenary Members

Dear Mr. Dudley,

Re: Response on the CPSS-IOSCO consultative report “Principles for Financial Market Infrastructures”

Introduction

The EPC welcomes the opportunity to comment on the CPSS-IOSCO consultative report on “Principles for financial market infrastructures”. The comments that the EPC would like to share are only comments on the principles for financial market infrastructures for payments.

We have divided our remarks into four sections: (i) the Financial Market Infrastructures for Payments in SEPA; (ii) some general remarks which are not specific to any particular part of the report; (iii) detailed remarks on the consultative report and (iv) some concluding.

I) The Financial Market Infrastructures for Payments in SEPA

SEPA

SEPA (Single Euro Payments Area) stands for a European Union (EU) integration initiative in the area of payments. The SEPA vision was set out by EU governments in the Lisbon Agenda of March 2000. Following the introduction of euro notes and coins in 2002, the EU governments, the European Commission and the European Central Bank (ECB) - focused on the integration of the euro payments market. They called on the payments industry to bolster the common currency by developing a set of harmonised payment schemes and frameworks for electronic euro payments. The European authorities supported this call by legislation (with a Payment Services Directive and 3 payment Regulations since 2001), turning the SEPA initiative into a mandated, legislator-driven transformation of the European retail payments landscape.



The main objectives of SEPA are:

- Integrating the multitude of existing national euro credit transfer and euro direct debit schemes into a single set of European payment schemes as a natural step towards making the euro a truly single and fully operational currency.
- Creating a SEPA for Cards which aims at ensuring a consistent customer experience when making or accepting euro payments and cash withdrawals with cards throughout the euro area.

SEPA is currently defined as consisting of the EU 27 Member States plus Iceland, Norway, Liechtenstein, Switzerland and Monaco. In SEPA, bank customers can make electronic euro payments within and across 32 countries under the same basic rights and obligations.

SEPA is created by co-regulation where the public sector takes care for the legislative part (such as the Payments Services Directive) and the EPC for the SEPA Rulebooks with business rules and standards and Frameworks with principles, relevant for the payments industry.

EPC

The European Payments Council (EPC) supports and promotes the creation of the Single Euro Payments Area (SEPA). For SEPA is the decision-making and coordination body of the European banking industry in relation to payments. The EPC develops the payment schemes and frameworks necessary to realise SEPA.

The EPC defines common positions for the cooperative space of payment services, provides strategic guidance for standardisation, formulates rules, best practices and standards and supports and monitors implementation of decisions taken.

The EPC is the Scheme Manager of the SEPA Credit Transfer Scheme (4491 scheme participants), the SEPA Core Direct Debit Schemes (3912 scheme participants) and the SEPA Business to Business Direct Debit Scheme (3384 scheme participants).

The EPC consists of 74 members representing banks, banking communities and payment institutions. More than 360 professionals from 32 countries are directly engaged in the work programme of the EPC, representing all sizes and sectors of the banking industry within Europe.

The European Central Bank (ECB) acts as an observer in all EPC working and support groups and in the EPC Plenary (the Plenary is the decision-making body of the EPC).

The EPC is a not-for-profit organisation which makes all its deliverables i.e. the SEPA Scheme Rulebooks, the SEPA Cards Framework and the PEACH-CSM Framework (with principles for the clearing and settlement of SEPA payments) available for download free of charge on the EPC Website. The EPC is not a supplier of technology or any goods or services. For more information visit the EPC Website at www.epc-cep.eu.

The EPC response on the consultation was developed in close cooperation with the EBF (European Banking Federation), ESBG (European Savings Banks Group) and the EACB (European Association of Cooperative Banks).

II) General remarks

As a preliminary remark, the EPC would like to underscore that its comments are written from the perspective of **participants (both direct and indirect) in SEPA financial market infrastructures for payments (FMIPs)**. Participants in FMIPs are Payment Service Providers (PSPs: Credit Institutions and Payment Institutions) as defined by European law. In this respect, the EPC notes that there is no formal definition of “participant” in the CPSS-IOSCO Principles and therefore invites CPSS-IOSCO to establish one for the purpose of this exercise.

As financial market participants (FMPs) in FMIPs, the **EPC fully shares the CPSS- IOSCO public policy objectives** of (i) enhancing the safety and efficiency of FMIPs; (ii) limiting systemic risk; and (iii) fostering transparency and financial stability. PSPs (Payment Services Providers) participating in FMIPs better fulfil their economic and societal role in stable financial markets. Only adequately designed and operated FMIPs may prevent financial shocks from being passed from one participant or system or market to the other.

Given the systemic nature of many FMIPs, and the central role they play in financial markets, the **EPC believes that the Principles should strike a right balance** between preserving financial markets’ stability and ensuring a fair competition among processors of the clearing and settlement layer (CSM’s and card processors) for the benefit of the their participants and their customers.

The EPC supports that **public policy action is taken to ensure the full achievement of the above-mentioned objectives**. Such action should however always rest on an objective, publicly-justified assessment of needs and requirements. In this respect it should be noted that the European financial services industry has invested significant energy and resources in better organising the FMIPs space since the introduction of the euro and the creation of SEPA.

In this respect, the EPC believes that it is essential that the principles for FMIPs are **fully consistent and coherent with the principles that are embedded in payment legislations such as the Payment Services Directive (PSD) that have been approved** and transposed in the national laws in Europe.

With regard to the implementation of the principles, the EPC agrees that, **whilst a degree of self-assessment by FMIPs is desirable, relevant authorities are expected to regulate and supervise FMIPs consistently with the Principles**. In this regard, as stated in the report coordination is of utmost importance, to avoid potential duplications or inconsistencies.

The EPC also understands that financial institutions, that do not operate any central system or perform any payment clearing and/or settlement function, and have only bilateral and commercial relationships with their customers, are excluded from the scope of the CPSS-IOSCO Principles. Conversely financial institutions which are overseen by Central Banks of the Eurosystem as SIPBs (Systemic Important Payments Banks) along the 2002 Principles for Systemic Important Payments Systems are expected to remain subject to the FMIPs principles. These principles therefore focus on infrastructures performing payment clearing and/or settlement functions to the market. However, as a result of the implementation of these principles, **FMIPs’ participants and participants’ customers could have to adapt to more stringent requirements**, be they retail financial institutions, corporates or SMEs.

The EPC understands that the proposed principles will be applicable for both **privately owned** and **publicly owned FMIPs** for “large value payment systems” and “retail payment systems”.

The EPC would like to explain that within SEPA a clear distinction is made for euro credit transfers, direct debits and for card payments between **three layers of a (retail) payment system**. These are:

1. the **services layer** of PSPs (Payment Service Providers) to their customers (competitive layer);
2. the **scheme layer** with the business rules and standards (cooperative space) and
3. the **processing, clearing and settlement layer** (competitive space).

PSPs delivering SEPA Credit Transfers and SEPA Direct Debits need to be a scheme participant of a scheme complying with the Eurosystem’s oversight framework (currently only the EPC’s schemes do so) and have several options to clear and settle their euro payments as laid out in the Clearing and Settlement Mechanism Framework. Clearing euro payments via an FMIP is one of the options, but bilateral clearing is also an option. In case the PSP decides to use one of the FMIPs to clear its euro payments, it is not only required to become a scheme participant of the SCT or SDD scheme(s), but also of the CSM (Clearing and Settlement Mechanism) of its choice.

The EPC recommends that the Principles acknowledge the existence of the three layers described above with which payment systems operate.

III) Detailed remarks

General organisation

Principle 1: Legal basis

An FMIP should have a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.

The EPC concurs with CPSS-IOSCO that **a legal framework that protects participants and participants’ customers of an FMIP from the latter’s insolvency is of the essence**.

As a general principle, the EPC is of the opinion that the **applicable law** governing the rights and obligations with regard to the settlement finality and netting **should be defined with respect to the localisation of the account of the PSP**, as provided for in the European Union (EU) by the Settlement Finality Directive (SFD) and the Financial Collateral Directive.

As regards conflict of law issues (3.1.10), **the choice of law cannot be an option for the determination of the law applicable to the system: this should be an explicit part of the Principles**.

Whenever FMIPs offer **ancillary services**, the EPC recommends these to be strictly separated from the core function of the said FMIP, in order to make risks transparent and understandable to the participants of the FMIP

Finally, the EPC fully agrees with the recommendation to **eliminate the “zero-hour rules”** as these may give rise to credit and liquidity risks. But for clarity, it is suggested that the phrase “*zero-hour rules should be eliminated*” is amended to read “*zero-hour rules should be eliminated by the appropriate authorities*” (3.1.6). The intention is of course to make it clear that such elimination may well not be within the power of an FMIP.

Principle 2: Governance

An FMIP should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMIP, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders.

It should explicitly be recognized that **FMIPs are either publicly or privately owned**, or have a mixed ownership (combination of private and public owners). These diverse ownership structures have implications for the governance of FMIPs, as have their relevant market (e.g. whenever an FMIP is a monopoly situation this creates more rights for direct and indirect participants and greater obligations for its owners). In addition the legislative context for a payment system (e.g. where participation – be it direct or indirect – in a FMIP is the consequence of a regulatory reachability obligation for PSP’s) has implications for a FMIP and for direct and indirect participants. These circumstances must be acknowledged by the Principles.

The EPC welcomes the explicit recommendation that “*the board should ensure that the FMIP’s overall strategy, rules, and major decisions reflect appropriately the interests of its participants*”. There is uncertainty however, as to how the above recommendation may be fulfilled if the board “*typically*” includes independent members, as also recommended by the principle on governance.

The **EPC is concerned that the interests of participants in the FMIPs may be simply addressed along with those of other stakeholders**. The recommendation that “*mechanisms for involving stakeholders in the board’s decision-making process may (our underlining) include user representation on the board, user committees, and public consultation processes*” seems to be worryingly pointing in that direction. It is not clear if this principle of having independent board members is also applicable at the scheme layer and at the processing layer.

It should be recalled that, in certain FMIPs, participants ultimately bear the default risk of the infrastructure. Therefore, it is the view of the EPC that there should be a clearer, more direct link between “*financial support*” and “*voice/representation*”. Similarly, while it is essential that a CSM has a **risk committee**, the EPC stands to be unconvinced that such a risk committee “*should be chaired by an (...) independent board member*” as this may not adequately reflect and does not ensure due action on the risk borne by the clearing members according to their fiduciary duties.

Furthermore, the EPC would like to underscore its support to CPSS-IOSCO as they note that **FMIP providing additional optional services that present a distinct risk profile from its core function**, should ensure that adequate legal and/or governance arrangement are in place to prevent possible conflict of interests and risk propagation.

On a more detailed level, the EPC also considers that the validation by an FMIP, on an ongoing basis, of the models and the methodologies it uses to quantify, aggregate and manage its risks is of utmost importance. We therefore believe that **the process of model validation should involve supervisory authorities**. Concretely, supervisors should have the power to assess the adequacy of the models to the general objectives pursued by an FMIP (as referred in Principle 1 on legal basis) as it is already the case for credit institutions.

Regarding systemically important payment systems (SIPs), we would suggest **to make a clear distinction between SIPs and other FMIPs in terms of governance**. SIPs are generally governed by the banking industry (CLS, HVPS, ACHs), or by central banks (for RTGS). In Europe, SIPs are only open to credit institutions because of the Settlement Finality Directive.

The EPC supposes that the governance principle will also be applicable for **FMIPs owned by the public sector**.

Principle 3: Framework for the comprehensive management of risks

An FMIP should have a sound risk-management framework for comprehensively managing legal, credit, liquidity, operational, and other risks.

The EPC agrees that any FMIP should take an integrated and comprehensive view of its risks, for all the three layers (1: services, 2: scheme and 3: processing, clearing and settlement layers as described in the General Remarks), including the risks it bears from and poses to its participants and their customers. The EPC backs the recommendation that FMIPs (scheme layer and processing layer) should manage risks from a comprehensive perspective and have a sound risk-management framework. Credit and liquidity risk management

Principle 4 and 7: Credit and liquidity risks

Principle 4: Credit risk

An FMIP should effectively measure, monitor, and manage its credit risk from participants and from its payment, clearing, and settlement processes. An FMIP should maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. A CCP should also maintain additional financial resources to cover a wide range of potential stress scenarios that should include, but not be 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.

Principle 7: Liquidity risk

An FMIP should effectively measure, monitor, and manage its liquidity risk. An FMIP should maintain sufficient liquid resources to effect same-day and, where appropriate, intraday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of [one/two] participant[s] and [its/their] affiliates that would generate the largest aggregate liquidity need in extreme but plausible market conditions.

The EPC only takes a position on credit and liquidity risks for FMIPs.

The EPC is of the view that that an FMIP should be required to apply **stable and robust risk management policies**, while supervisors should carry out intensive and efficient oversight functions, so as to avoid that an FMIP can face the possibility to be liquidated.

The EPC agrees with the definition of credit risk and liquidity risk provided by CPSS-IOSCO. We underline the **importance of the “high degree of confidence”** between direct participants, indirect participants and FMIPs for all three layers in the risk coverage process. FMIP’s transparency towards its direct participants is of the essence on stress scenarios, assumptions and methodologies.

As regards **liquidity risk management**, the EPC believes that, subject to the conditions listed below, the cover one scenario should be the minimum requirement for payment systems. A major reason for this is the likely limit on the availability of suitable collateral which may also be required for a range of other purposes including Basel regulatory requirements, monetary policy operations and other FMIPs. The concern we have is that stipulating a minimum cover two requirement (failure of the largest two clearing members) could result in some institutions relying on other participants’ liquidity by delaying outward payments which would not only reduce operational efficiency but also potentially create additional risk for the other participants who may effectively be acting as unsecured liquidity providers. Whilst cover two should not be an across the board, minimum requirement, it should be considered whenever interdependencies between markets and systems create much higher levels of potential risks.

However, this proposal is subject to the following three conditions:

- Group situations where participants are financially linked are treated as one participant for this purpose and the phrase “*participant and its affiliates*” is not considered sufficiently explicit. Instead, it should be replaced with more formal group criteria, possibly based on Basel principles. It follows that several participants (and their affiliates) may be counted as a single entity for cover one purposes.
- When applying this requirement, it must be possible for payment systems to measure and control the highest intra-day credit risk, where applicable, and this requirement should be applied to such risk. For DNS systems, the term “intra-day” should be construed as being the highest credit risk arising during the deferred settlement process based on the underlying legal infrastructure. It is acknowledged that some payment systems may require time to accommodate this requirement but it is considered important that the underlying principle should be established.
- Robust default procedures , including where two or more participants fail simultaneously, with mandatory testing at least annually and more frequently if material changes are made, should be put in place so that in a crisis situation they can be implemented without delay.

Principle 5: Collateral

An FMIP that requires collateral to manage its or its participants’ credit risk should accept collateral with low credit, liquidity, and market risk. An FMIP should also set and enforce appropriately conservative haircuts and concentration limits.

The EPC only takes a position for collateral requirements for FMIPs.

Considering the increasing scarcity of available collateral, the EPC considers that an **FMIP should dynamically adjust its requirements for acceptable collateral**, in accordance with changes in underlying risks.

The EPC notes that, in a situation of market stress, any given FMIP's survival reflex may enter into contradiction with the preservation of wider market stability. For that reason, the EPC strongly supports the recommendation that **FMIPs should have in place an appropriate collateralisation policy that reduces to the maximum extent possible haircuts** that can have a pro-cyclical impact on the market.

Furthermore, as regards the reference made to the use of cross-border collateral to provide an efficient liquidity bridge across markets, the EPC would like to emphasise that an FMIP should have the proper legal and operational assurance to ensure it can use the cross-border collateral within SEPA in a timely manner.

Settlement

Principle 8: Settlement finality

An FMIP should provide clear and certain final settlement, at a minimum, by the end of the value date. Where necessary or preferable, an FMIP should provide final settlement intraday or in real time.

The EPC recommends that it is made clear in this settlement finality principle for FMIPs that rules cover both the finality at transaction level and the finality at inter-bank level.

The EPC believes that **settlement finality is a major component of systemic stability and should therefore be guaranteed**. Finality comes at the very end of the settlement process and it ensures the certainty of the ability to use, for any possible purpose, the cash and securities liberated by the finalisation of the settlement of a trade. The principle is already applied in the EU through the Settlement Finality Directive.

Due to the importance of settlement finality in preventing credit, liquidity, and potentially systemic risk, the EPC would suggest that CPSS-IOSCO provides for **a common definition of settlement finality**. At least, it would be desirable, in the explanatory note 3.8.2 ("Final settlement"), to make a statement about the need of reaching a global agreement on the definition of settlement finality. This would be particularly useful for the smooth operation of cross border payments.

In addition, while the EPC fully agrees that intraday or real time settlement is "preferable" to end of value date settlement, in order to reduce settlement risk, the EPC encourages CPSS-IOSCO to consider adding a **target of settling multiple times intraday or in real time**. The EPC also believes that the continuous optimization of settlement algorithms should be encouraged.

Finally, in the explanatory note 3.8.6 ("Revocation of transfer instructions"), the words "*or discourage*" should be deleted as settlement rules should be clearly defined, in particular where a stress situation occurs.

Principle 9: Money settlements

An FMIP should conduct its money settlements in central bank money where practical and available. If central bank money is not used, an FMIP should minimise and strictly control the credit and liquidity risk arising from the use of commercial bank money.

As regards settlement on the books of an FMIP (3.9.6.), the EPC points out that **an FMIP established as a “special-purpose institution” that provides banking-type services**, though strictly related to settlement activities, **should be required to hold a banking license and be subject to prudential supervision**, irrespective of what the legislation of a jurisdiction may request. This is essential not only to ensure that there is a level-playing field between institutions that are able to provide similar services but above all to prevent risk propagation from activities that bear credit risk to low-risk core settlement-related activities that an FMIP may perform.

Default management

Principle 13: Participant-default rules and procedures

An FMIP should have effective and clearly defined rules and procedures to manage a participant default that ensure that the FMIP can take timely action to contain losses and liquidity pressures, and continue to meet its obligations.

The EPC agrees that continued operability of an FMIP in distressed situations is of the utmost importance and, therefore, backs the principle that FMIPs have access to additional resources (e.g. the default fund; the FMIP’s own funds). It is, however, important that the **scenarios and conditions for using those resources (e.g. waterfall mechanisms) are clearly defined**.

General business and operational risk management

Principle 15: General business risk

An FMIP should identify, monitor, and manage its general business risk and hold sufficiently liquid net assets funded by equity to cover potential general business losses so that it can continue providing services as a going concern. This amount should at all times be sufficient to ensure an orderly wind-down or reorganisation of the FMIP’s critical operations and services over an appropriate time period.

While the EPC sees the policy rationale of covering all kinds of potential risks FMIPs could face and understands the proposal that FMIPs should hold sufficient equity capital to cover potential general business losses so that they can continue providing services as a going concern or achieving an orderly liquidation, **any capital requirements or similar requirements (such as guarantees) associated with the introduction of this new category of risk should be offset by a reduction of capital or similar requirements from participants in the said FMIP**.

The EPC also notes that this Principle requires an FMIP to “*hold sufficient liquid net assets funded by equity to cover general business losses so that it can continue providing services as a going concern*”. The question is then posed as to what period of operating expenses should be covered. This requirement does not appear to take properly into account different ownership structures and the different levels of risk these bring to the system. In particular this requirement does not seem appropriate in situations where the infrastructure is owned by the users as opposed to third-parties. In view of the short term nature of payment systems settlement, yet taking into account the yearly cycles any payment system is exposed to, **six months operating expenses are considered acceptable for payment systems** in order to have sufficient time to make alternative arrangements. Finally, notwithstanding the description given here and the remarks made by CPSS-IOSCO in the cover note to the consultative report, it is suggested that **a formal definition of equity capital or undisputedly available substitutes should be provided**. Also, it is unclear why **holdings of liquid net assets need necessarily be funded by equity and not by a guarantee of the scheme**

participants in the case of payment systems provided that such assets are ring-fenced and specifically dedicated to this purpose.

Principle 16: Custody and investment risk

An FMIP should safeguard its assets and minimise the risk of loss or delay in access to those assets, including assets posted by its participants. An FMIP's investments should be in instruments with minimal credit, market, and liquidity risks.

The EPC supports the provisions on investment risk, in particular the requirement for an FMIP to safeguard its assets in supervised and regulated entities that have robust accounting practices and safekeeping procedures.

While the EPC agrees that an FMIP should have an easy and prompt access to its assets and that its investment strategy should be consistent with its overall risk-management strategy.

The EPC is however concerned by the possibility given to an FMIP to invest participant assets. The EPC believes that **an FMIP should not be allowed to invest the collateral provided by its participants**. Collateral serves to limit counterparty risk. Investment of collateral implies other types of risk, which could jeopardise the very purpose of collateral.

Finally, financial markets being global and FMIPs more and more interoperable (such as the Interoperability Framework of EACCHA), safeguarding FMIPs' assets and those of their participants is crucial for securing financial stability. Against this background, regulators should be particularly vigilant in **ensuring that assets are protected at all times on a global scale irrespective of the jurisdiction where they are posted**.

Principle 17: Operational risk

An FMIP should identify all plausible sources of operational risk, both internal and external, and minimise their impact through the deployment of appropriate systems, controls, and procedures. Systems should ensure a high degree of security and operational reliability, and have adequate, scalable capacity. Business continuity plans should aim for timely recovery of operations and fulfilment of the FMIP's obligations, including in the event of a wide-scale disruption.

The EPC supports the principle that an FMIP should establish a **robust operational risks-management framework** that should allow complete and rapid identification, monitoring, management and prevention of operational risk. Appropriate systems, policies, procedures and controls to minimise operational risks should also be made available to all FMIPs' participants (in their capacity as users of infrastructures) to ensure transparency in risk management.

The EPC would however suggest requesting an FMIP to **have a clear and precise classification of the operational risks** it may encounter in the conduct of its activities. In order to facilitate the identification of risk and foster the prevention of it, an FMIP could be encouraged to put in place a system of identification of operational risks. Such a system could be composed of (at least) two levels of risk management: first, the management of minor but more frequent errors; second, the management of more serious and disruptive events. Each kind of operational risk should be addressed by specific requirements that would be defined according to the nature and relevance of the risk concerned.

The EPC particularly welcomes the provision on business continuity planning that we regard as extremely important and necessary so as to ensure that an FMIP is able to carry on its functions in all circumstances. The EPC however stresses that **in case of operational problems, the participants of an FMIP are the first to be impacted**. Therefore, we would welcome a requirement on FMIPs to inform their participants of any operational failure which they may experience. This would enable participants to adopt internal appropriate measures to cope with the situation as soon as possible. Such an obligation could take the form of time and communication requirements.

Finally, **regular testing** is of such crucial importance that it is suggested that a maximum period between major tests should be stipulated e.g. the FMIP must operate from its back-up site for at least a full business day including any associated night-time processing during a 12 month period based on the assumption that the primary site has been destroyed and no personnel or records have survived including top management.

Principle 18: Access and participation requirements

An FMIP should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access.

The EPC agrees with CPSS-IOSCO that an **FMIP should permit participation to its services on the basis of fair and open access**. Whilst access to an FMIP cannot be indiscriminate for risk reasons (participants in an FMIP should be subject to certain objective risk-based requirements), it is equally important for the Principles to acknowledge that disproportionate access conditions create risks of their own. The number of direct and indirect participants has an impact on the risk profile of an FMIP and on the competitive structure of the clearing of payments in that market.

In particular in situations where participation whether direct or indirect in an FMIP is the consequence of a legislative mandate and/or where the said –public or private- FMIP is implicitly or explicitly a dominant FMIP in a relevant market, then the Principles should allow for direct participation to become the objective. The consequence is that such direct participation, based on objective risk based criteria, becomes an option for a greater number of PSPs concerned. Whenever such broad direct participation would not be possible, then the obligation for direct participants to at all times segregate and ringfence funds destined for an indirect participant should be recognised in the Principles.

It is also suggested to add a second sentence to the principle which would read as follows: *"Where appropriate under local law and/or regulation, these should be subject to competition law approval"*. In the context of the European single market, it is indeed crucial that these access rights are harmonised within the EU, which is not the case today.

Furthermore, **participation requirements for an FMIP should be transparent** and should allow for remote access to the extent that this does not expose the FMIP to additional risks.

Considering its impact on competitiveness, access to an FMIP should be regularly monitored by corresponding competent authorities.

Finally, the EPC reminds CPPS-IOSCO of the importance to address exit procedure with clear criteria, the adherence to which should be closely monitored by competent authorities. **Exit criteria should be clearly spelled out** and take into due consideration the impact that the exit of a large market participant could have on an FMIP's stability. Rules on asset segregation are thus instrumental in providing safety to the non defaulting members (Principle 14). Supervisory authorities should resort to all available tools to preserve the stability of an FMIP in case of rumors on the possible exit of a participant in an FMIP.

Principle 19: Tiered participation arrangements

An FMIP should, to the extent practicable, identify, understand, and manage the risks to it arising from tiered participation arrangements.

The EPC agrees in principle with CPSS-IOSCO that an FMIP should try to identify, understand and manage the risks arising from tiered participation arrangements. The Principle should however better define what is meant by “*to the extent practicable*”.

The EPC nevertheless points out that this Principle could be very **difficult to implement**. Most CSMs (Clearing and Settlement Mechanisms) are not in a position to identify their participant's customers. Furthermore, FMIPs are not supervisors and should not be so. The EPC believes that the issue is less about granting an FMIP powers that are inherent to supervisors, but rather to require the latter to set objective criteria on tiered participation arrangements and a clear allocation of responsibilities between FMIPs and supervisory authorities.

While the EPC concurs with the need to adopt a cautious and targeted approach to risk, we are concerned by the technical constraints an FMIP may face in identifying and managing the risks that indirect participants could present. The EPC therefore invites CPSS-IOSCO to **involve local regulatory authorities in the supervision process of the criteria and procedures defined by an FMIP to manage risks arising from tiered participants**. We believe it is crucial for the FMIP but also for the local supervisor to have a clear vision of the risk arising from tiered participants and to be able to identify the source of such risk.

The involvement of the regulator is also particularly important in the default procedures of an indirect participant (3.19.6). In particular, we note that the phrasing “*to the extent practicable*” can lead to misunderstandings or different interpretations. Consequently, the EPC invites CPSS-IOSCO to provide more clarity on the procedures an FMIP would be expected to put in place to face a default of an indirect participant.

Generally speaking, the EPC is **concerned by the extent an FMIP can or should try to interfere in a commercial relationship between one of its members and its customers**, relationship of which it may well have no direct visibility.

Principle 20: FMIP links

An FMIP that establishes a link with one or more FMIPs should identify, monitor, and manage link-related risks.

The EPC assumes that the links between FMIPs refer to the concept of **interoperability**. The EPC supports the development of interoperability arrangements as one of the options to serve the SEPA market, and recognizes the Interoperability Framework of EACHA and of EAPS in SEPA.

European banks have nevertheless continuously stressed that it is of absolute necessity to have clear, strict, sound and robust risk management rules for the establishment of such arrangements.

Furthermore, the EPC stresses that FMIPs should not be competing on the basis of risk management standards. Their risk management arrangements should be subject to regulatory approval and be published to participants. In particular **cross-border FMIP links should be subject to close supervision by competent authorities**. In this respect, any memorandum of understanding establishing cross-border links should obey to close supervisory requirements and should be based on equivalence recognition, to the extent possible.

Finally, the EPC recalls that there should only be one system providing settlement finality for any transaction (see our comments to Principle 8).

Efficiency

Principle 21: Efficiency and effectiveness

An FMIP should be efficient and effective in meeting the requirements of its participants and the markets it serves.

The EPC supports this Principle. For all FMIPs the appropriate balance should be agreed between service level, cost and risks for participants (be they direct or indirect).

Principle 22: Communications procedures and standards

An FMIP should use or accommodate the relevant internationally accepted communication procedures and standards in order to facilitate efficient recording, payment, clearing, and settlement across systems.

The EPC generally supports this Principle but would recommend **keeping communication protocols and standards at a scheme level and not at a messaging level**. As far as communication protocols and networks are concerned, we also believe it is essential that regulators worldwide can check and ensure that there is a **level playing field**, also in terms of oversight, between the different solutions offered to market participants.

Transparency

Principle 23: Disclosure of rules and key procedures

An FMIP should have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks they incur by participating in the FMIP. All relevant rules and key procedures should be publicly disclosed.

The EPC backs the principle that an FMIP should provide sufficient information to its participants and prospective participants to enable them to identify clearly and understand fully the risks and responsibilities of participating in the system. Such principle should, however, be subject to the following **limitations**:

- **Detailed information on a FMIP's rules and procedures and/or a description of a system's design and operations** that may compromise the infrastructure's safety and integrity (risk of fraud or attempted fraud), or may contain commercially sensitive information, should not be disclosed to parties with no legitimate interest in it. It is therefore

suggested to add: *"except where such disclosure may risk prejudicing the security and integrity of the system or divulging commercially sensitive information"* to the sentence *"All relevant rules and key procedures should be publicly disclosed"*.

- **Information on fees and discounts** should not be disclosed to the public: these fees are paid by institutions to service providers and have only an indirect impact on the price charged to end customers.

Furthermore, public disclosure is referred to in various parts of the consultative report with various qualifications but it is considered important that care is taken throughout the report to **ensure that neither safety nor integrity are compromised and commercially sensitive information is safeguarded**.

Finally, the EPC calls for a **level-playing field** when implementing this Principle so that all relevant communication shall be available without discrimination to market participants.

IV) Concluding remarks

The **EPC supports the objectives set forth by CPSS-IOSCO**. Robust and sound FMIPs are crucial for ensuring a smooth functioning of financial markets in all conditions, even the most stressful ones. Smart regulation of FMIPs is, therefore, instrumental in instilling confidence that all such systems can withstand the most severe shocks.

Given the systemic nature of many FMIPs, and the role they play, the EPC believes that the Principles should strike **a right balance between preserving financial markets' stability, ensuring a fair competition among processors of the clearing and settlement layer (CSMs and card processors) for the benefit of their participants and their customers**.

Consistent implementation of the CPSS-IOSCO Principles at the international level is of utmost importance, not only for ensuring a level playing field, but above all for preserving the soundness and stability of the FMIPs themselves.
