

Brussels, 13th July 2011

CPSS secretariat
cpss@bis.org
IOSCO secretariat
fmi@iosco.org

Dear Sirs

Consultative report re: Principles for financial market infrastructures

As the world's premier voice and electronic interdealer broker ("IDB") and provider of post trade risk and information services, we pay particular attention to the development of a robust financial market infrastructure. As we intermediate over €1.6 trillion in trading across all asset classes daily, we recognise that the market infrastructure is key and fundamental to the proper functioning of the global economy. The regulatory framework currently undergoing extensive review will enhance market resilience and investor confidence, while allowing the continued scope for innovation and user choice that is so vitally important.

An interdealer broker draws together willingness to buy and sell in wholesale markets. ICAP uses voice broking and electronic networks to bring those interests together. In many markets voice brokers help to create liquidity and facilitate the price discovery process. This is particularly important in non-standardised, bespoke markets where the number of parties willing to enter into transactions may be limited.

As shown during the recent financial crisis, the flow of liquidity needs to be considered as a key issue and should be supplemented by robust post trade risk services to help customers reduce operational and systemic risk in their markets. This increases their capacity, reduces their costs and creates new trading opportunities. Ahead of regulatory pressure on financial market participants, we have invested in the overhaul of OTC market infrastructures – reducing systemic and operational risk by improving back office procedures and reducing counterparty risk. Our post trade risk and information business is comprised of Traiana, the transaction processing businesses and Reset, TriOptima and ReMatch as well as our information business. For more detailed information we refer to our annual report available on our website www.icap.com

Generally, we would like to congratulate the group who compiled the consultative report on the quality of the document. In general it highlights the appropriate issues, although a number of topics may need some additional work in order to increase the quality of the global standards envisaged.

The G20's goal of addressing key systemic risk issues can only be met with international coordination in market infrastructures, regulatory transparency, and counterparty credit risk. The CPSS-IOSCO work plays a crucial role in this regard as it should create the basis for a global regulatory approach. Important to note is the G20 fight against protectionism and the commitment to take action at a

national and international level to raise standards together so that national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage.

Recent steps taken by the United States and Europe to date may lead to fragmentation, protectionism and regulatory arbitrage in the regulation of the derivatives business, ultimately decreasing the ability of global regulators to effectively regulate an increasingly global capital marketplace. Extra-territorial application of one nation's laws to another nation's markets and firms is a fundamental concern in a global market like derivatives, where it is common for counterparties based in different parts of the world to transact with each other.

Recent rhetoric in public pronouncements by leading decision-makers from Europe and the United States suggests that insufficient emphasis is being attached to problem-solving and avoidance of conflicts and unnecessary burdens. As a result, we urge CPSS-IOSCO to step up their surveillance of current regulatory implementation and to enforce key systemic risk measures in a spirit of international coordination in market infrastructures, regulatory transparency, and counterparty credit risk.

We have set out our thoughts below in response to the Consultation Paper and have limited our responses to the topics we deem most important for our business or in general. We would like to draw your particular attention to our response regarding Annex E Part 1 b that favours the vertical model as developed by some market infrastructures. This includes a misleading description of the vertical business model compared with the benefits of others.

Yours faithfully

A handwritten signature in black ink, appearing to read "De Vidts", with a long horizontal line extending to the right.

Godfried De Vidts

Director of European Affairs, ICAP

Introduction

The most recent financial crisis has witnessed an interruption of the regular flow of liquidity to whole sale market participants. Not only has unsecured funding to whole sale market participants ceased but trust in counterparties has equally been under severe pressure. In that respect, the use of collateral as a risk mitigation measure has taken on added importance, while reforms under Basel 3 will increase pressure on the availability of the choice of various types of collateral such as fixed income government or corporate bonds, equities and bank loans.

Financial market infrastructures (FMIs), as highlighted in the introduction of this consultation paper, facilitate the settlement of collateralised trading or transmission of adequate collateral to accommodate payments of cash and securities for centralised clearing infrastructures.

Amongst such intermediaries are global custodian or agent banks. Financial markets are global and participation requires the use of multi-currencies or collateral of multi-currency denominations. Access for market participants is generally provided by a few major global custodian banks which provide facilities to their clients allowing access to centralised clearing facilities (CCPs), General Clearing Members (GCMs) or corresponding payment facilities through domestic agent banks, both in cash and securities. Because of the additional layer of complexity between CCPs and (I) CSDs in particular, domestic agent bank delays can occur in the transmission of cash or securities. In the case of multi-currency transactions instructed by CCPs or through the ICSDs, the risk of delays or, at worst, the potential default of the agent bank should be addressed at a global level.

ICAP encourages the use of CCPs for all instruments as a means to foster financial stability. However, limited attention is given to the role of agent banks as FMIs. Although central bank liquidity for settlement purposes by CCPs seems to be preferred, the use of commercial bank money is unavoidable for domestically (in case of non-direct participation in the clearing system by domestically located financial institutions) and internationally active indirect participants. Relevant authorities may want to elaborate more on this issue, as it covers multiple regulatory issues beyond the scope of CPSS-IOSCO.

In addition, the global nature of multiple products requires an adequate global supervision in order to avoid a race to the bottom. In particular, the role of CPSS-IOSCO should be highlighted here, as adequate timely supervision of implementation of principles and responsibilities should be agreed upfront, avoiding frictions particularly in stress situations. Indirect participants established in other jurisdictions should have fair and open access to CCP services while authorities' assessments should be publicly disclosed to allow adequate supervision by all parties concerned.

Ahead of possible events the public policy objective should make sure excessive competition between FMIs is managed, as in particular the evaluation procedures of CCPs may lead to lowering risk standards. Small differences in the evaluation of underlying assets is possible but recent events in European sovereign issues have clearly exposed a huge gap between different parties relating to the same underlying.

Although we fully understand the issue around "fire sales" we would caution about undue regulatory involvement by concerned parties in contractual arrangements. Many legal provisions aim to deal with the event of defaults which are designed to help the non-defaulting party protect against undue counterparty risk. Creating delays and uncertainty on rights of action may in turn

undermine confidence in markets and freeze up liquidity in stressed conditions just when it is most needed.

1. Principles for financial market infrastructures

Principle 1. Legal basis

ICAP fully subscribes to the need for certainty around settlement finality. Similar to our broking activities, either through voice or electronic systems where trades are at a point of no return immediately after conclusion, settlement finality should be tightened for risk-management systems, allowing clarity through law on the irrevocability of the transactions. 3.1.6.

Principle 2. Governance

Sufficiently knowledgeable independent board members for a CCP risk committee are crucial, while the majority of board members should be independent of management. This is particularly important for profit models where temptation to increase risk for profitability reasons may lead to adverse judgment of board members. 3.2.12.

Principle 3. Framework for the comprehensive management of risks

Penalties to participants that fail to settle securities should be possible but only after full investigations of the cause of the failure have been completed. Any other attempt for financial penalties should be avoided, as the root cause of such happenings may be more important in light of avoidance of future systemic risk. 3.3.5.

Principle 4. Credit risk

If payment systems, CSD or SSS require collateral, the collateral received should be evaluated on a regular and daily basis. If the value of the collateral proves inadequate additional collateral should be provided. For the purpose of payments systems, CSD or SSS, haircuts should not apply. 3.4.5

For CCPs, current and future potential exposures should be covered by appropriate eligible assets while prudent haircuts are acceptable. ICAP suggest that the framework for appropriate haircuts is pre-announced so users, as well as the regulatory community, are fully aware of potential short term changes, when appropriate. 3.4.9.

Principle 5. Collateral

CCPs have a duty to protect their franchise and sudden, adverse regulatory curbs should not intervene in this process. The proposal re: procyclicality will not prevent financial instability but will increase overall costs for market participants. Regulatory intervention in times of stress should be appropriately co-coordinated and procedures should be written down to avoid unilateral action. This may help identify inappropriate marked down haircuts in times of low market stress. 3.5.5.

Principle 6. Margin

Having two or more CCPs authorized to offer cross-margining will provided additional comfort under the four-eye principles as this environment will provide benefits of additional control, particularly if interoperability between the CCPs is established.

Principle 7. Liquidity risk

An FMI should maintain sufficient liquid resources – i.e. liquid assets and prearranged funding arrangements. The most recent crisis has shown that this should be committed, guaranteed, prearranged funding arrangements. This may actually be covered by Basel 3-CRD IV regulatory proposals, as committed lines where capital has to be set aside make for a more prudent allocation of such facilities.

If an FMI allocates potentially uncovered liquidity shortfalls to its participants the impact on liquidity provisions must be kept in mind. Hence timely and accurate communications is crucial to avoid an adverse systemic risk impact. 3.7.17.

Principle 8. Settlement finality

Final settlement, intraday or in real time, is crucial as it allows re-use and improves liquidity. This would, to a degree, diminish the pressure of liquidity decreases of central bank bond purchases, as well as some CCP activities that may be holding collateral as margin.

Regarding footnote 64, every effort should be made to encourage early settlement in the night cycle preceding the actual value date. The benefits of this procedure is highlighted in the European Repo Council White Paper

<https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Repo-Markets/European-repo-market-white-paper.aspx>

Care should be taken regarding the reversal or unwinding of transactions. This can be best illustrated by the Parmalat case where a full reversal of coupon payments occurred after a considerable delay. FMIs should prevent such intrusive procedures by tightening up the rules that govern important coupon payments. 3.8.2.

Principle 18. Access and participation requirements

ICAP fully endorses the principle of fair and open access to FMIs , in particular to CCPs and for all products. Regulatory interest has recently focused on the enhanced use of centralized clearing, possibly even mandated for a number of products. Hence it is most importance that objective, risk-based and publicly disclosed criteria for participation are provided. The principle should apply to all actors in the wholesale market, including Interdealer Brokers (IDBs), whether execution happens through voice broking or electronic trading.

Principle 20. FMI links

The identification of link-related risks can greatly be helped by having two or more CCPs connecting to each other as they provide industry cross-checking of evaluations. This should help avoid national regulatory supervision from being adversely influenced. 3.20.2.

Regarding footnote 119, CCP interoperability and, in particular, allowing for portability will broaden trading opportunities but, equally, provide ground for positive competition to what otherwise may lead to regulatory endorsed monopolies. This could occur at the detriment of innovation that may also lead to uncompetitive pricing for services.

Provisional transfer of securities should indeed be prohibited, as only real-time effective transfers should be permitted. 3.20.7. Principle 8 re: settlement finality should apply.

Principle 21. Efficiency and effectiveness

FMI, in particular multiple CCPs, for every single currency zone globally may not be efficient. Hence regulation should not limit the choice of a clearing and settlement scheme to a domestic currency zone, as appropriate cross-currency management may be available. This would greatly improve the efficiency of centralized clearing, not only by decreasing counterparty risk but equally by avoiding multi-CCP default fund management by all concerned.

Principle 22. Communications procedures and standards

Regarding Footnote 130, it is questionable whether the rejection of internationally accepted communication standards for purely domestic transaction would be wise. This may prove to be expensive in the long run, as it will create significant barriers for users that eventually may need to go beyond domestic transactions. Furthermore, for the purpose of creating Trade Repositories this may prove to be counterproductive.

Annex C. Recommendation 2 Trade confirmation

This article may benefit from highlighting the need for trade affirmation immediately at the point of trade, whereas trade confirmation may be delayed a little but not beyond trade date.

Annex E. Guidance for CCPs that clear OTC Derivatives

Part 1. (b). It is highly questionable that multiple electronic trading venues in OTC derivatives that are not directly affiliated with a CCP, such as listed markets, may cause concerns regarding processing efficiency, operational liability, interoperability and open access. To the contrary, innovation and demand of the most advanced techniques in the OTC derivative markets have provided ample proof of the adequate robustness at par or even beyond systems provided by listed markets. The lack of adequate investment by listed markets has resulted in multiple breakdowns of trading systems offered by exchanges in recent years, compared with the state-of-the-art electronic trading venues, not only in equities but including bonds and OTC derivatives. ICAP finds this article highly misleading and would strongly advise a revision of such an ambiguous article.