

Committee on Payment and Settlement Systems
International Organization of Securities Commissions

Comments on the CPSS/IOSCO Consultative report, *Principles for Financial Market Infrastructures*

1. Introduction

Japan Securities Depository Center, Incorporated (JASDEC) is an institution authorized by the Prime Minister and the Minister of Justice to undertake book-entry transfer business under Act on Transfer of Bonds, Shares, etc. JASDEC was established as a non-profit foundation in 1984, and in 2002 became a joint stock corporation. JASDEC's book-entry transfer system currently includes stocks, commercial paper, corporate bonds and investment trusts, and the organization also handles such activities as custody services for foreign stocks, etc. and pre-settlement matching.

This document contains our comments on the CPSS/IOSCO Consultative report, *Principles for Financial Market Infrastructures*, that was released on March 11, 2011. We would like to express our gratitude for being given the opportunity to participate in the consulting process.

At JASDEC, we greatly respect the continuous efforts being made by CPSS-IOSCO to contribute to financial market stability. We sincerely hope that this consultative process and subsequent investigations will result in the development of sound financial market infrastructure principles and further improvements in clearing and settlement stability and efficiency.

2. Comments

【Introduction】

(1.30)

It states in 1.19 that 'the principles do not prescribe a specific tool or arrangement to achieve

their requirements and contemplate different means to satisfy a particular principle', and about the explanatory notes, it is explained that, 'An accompanying explanatory note discusses the objective and rationale of the standard and provides guidance on how the standard can be implemented (1.30).' However, in the actual written contents, there is no shortage of passages in which the principles go beyond guidance to prescribe what appear to be specific methods and systems. At the very least, where a management method is included, we would like its status to be restricted to that of guidance.

(1.30)

We believe that the 'Key questions' and 'Assessment methodology' could have a significant impact on each FMI's application of the *Principles for Financial Market Infrastructures*. Moreover, in these revised *Principles* a number of new items have been included. Accordingly, the 'Key questions' and 'Assessment methodology' should be included in the market consultation process.

Principle 1: Legal basis

(3.1.10.)

Securities are traded globally, and with multi-tiered structure of participation currently in widespread use, it is unfeasible on a practical basis for FMIs to 'obtain reasoned and independent legal opinions and analysis of the enforceability of its choice of law in relevant jurisdictions' to help achieve legal certainty on conflict of laws issues.

FMIs already seek reports and opinions from legal specialists as necessary in operating their businesses, so taking into account a comprehensive consideration of importance, speed and cost, we think a certain amount of flexibility should be allowed here. It should be made clear that it is not necessary to obtain legal opinions with regard to all applicable laws.

Principle 2: Governance

(3.2.9.) (3.2.12.)

Our understanding is that this principle, rather than proposing a specific governance structure, permits diverse governance arrangements depending on factors such as regulations in different countries and the ownership structure and organizational form of each FMI.

However, some items in this principle, such as 3.2.12, do not appear to allow a diversity of approaches, so we think that these items need to state that a variety of governance

approaches will be acceptable.

In support of this, for example, a number of different governance systems could be enumerated; or, if it proves difficult to include such descriptions, the aim and intent of the governance principles could be clarified, along with examples of undesirable structures or particular governance methods that should be avoided.

Principle 3: Framework for the comprehensive management of risks

(Key consideration 2) (3.3.2.) (3.3.4.)

This principle places obligations on FMIs not only for their participants but also for participants' customers. We think that the uniform application of this obligation, even to FMIs that do not have any direct relationship with participants' customers, will give rise to situations that diverge considerably from the current operations of FMIs and the rules and regulations relating to FMIs.

Accordingly, we believe that further careful deliberation is required if this section is to be incorporated into the principles. And if it is incorporated, it should be made clear that the approach can be tailored to the actual circumstances of each FMI, by using terminology such as, "...participants and (if applicable) their customers..."

(3.3.4.)

Information and control systems should be constructed to reflect the operational nature of each FMI. Because the operations of CCPs and CSDs are different, the items to be addressed in information management systems are also likely to be different. In the current explanation, however, all FMIs seem to be requested to operate an information and control system where CCPs are envisaged, so we would like to see this changed so that FMIs can construct information systems that reflect their particular risks.

Principle 13: Participant-default rules and procedures

CCP and CSD rules and procedures for participant default are markedly different from each other. The critical aspect of procedures for CSD participant default is the relationship with third parties (the creditors and customers of the defaulting participant), and this should basically be defined within the scope of the law. In each country there are differences in the provision of law whether FMI rules and regulations have the same legal effect as the law, so we believe that the principles should be written in a way that avoids any implication that it can be resolved through FMI rules and regulations.

Principle 15: General business risk

(3.15.6.)

Although we can understand the importance of FMIs operating as going concerns needing to have a certain minimum quantitative level of secured capital, we believe that specific amounts should be established by each FMI, as appropriate for the risk-scenario envisioned by each FMI.

(3.15.8.)

This principle gives a detailed prescription for planning with regard to capital procurement, business withdrawal and reorganization in order to avoid systemic disruption. The plan is expected to be updated regularly (regardless of how probable withdrawal or restructuring might be) and has to be approved by the board of directors (or an appropriate board committee). While it is important to create a framework system, considering that different approaches to governance are taken by different countries, we think that including detailed methodology in this principle may have the effect of preventing a flexible response.

Principle 17: Operational risk

(3.17.2.)

It is unclear what specifically is meant by 'potential single points of failure', and realistically it could be problematic defining all such risks. We therefore would like to see this principle rewritten to provide the guidance reflecting the practical business.

(3.17.13.)

It is unclear what kind of alternative arrangements is envisaged whereby an FMI could process time-critical transactions in the extreme circumstance that none of the FMI's sites are operational, so we would like to see a specific example included here. Although it will depend on the content, in the first instance we think FMIs should be required to develop a proper understanding of the risks pertaining to their own operations—including the possibility of simultaneous disaster scenarios—and prepare detailed business continuity plans accordingly.

(3.17.18.) (3.17.19.)

It is not clear what specific kind of situation is envisaged in which authorities would need "full access to the necessary information". If the purpose is to give the authorities the right to directly investigate the FMI's third-party service providers, we think the principle goes too far.

Also, if it means that contracts between FMIs and third-party service providers will need to include an additional clause that gives authorities full access to information, then a legal framework will likely become necessary, with the disadvantage that this may restrict the scope of potential contractors. Considering these factors, we would like to see a certain amount of flexibility retained in this principle.

Principle 19: Tiered participation arrangements

Our understanding is that this principle says that FMIs are required, to the extent practicable, to identify, understand and manage risks arising from tiered participation arrangements. However, in 3.19.5. it states that an FMI should ensure that its rules, agreements and procedures with direct participants allow it to gather basic information about indirect participants, and note 117 states that an FMI may be able to obtain this information through its internal systems or by requesting it from direct participants. Because of factors such as the absence of any contractual relationship between CSDs and indirect participants, we believe that it would not in reality be easy for an FMI to obtain information on indirect participants via direct participants. Accordingly, we would like this principle to be revised in a way that more closely reflects actual circumstances.

Principle 20: FMI links

With regard to the scope of the measuring, monitoring and managing of link-related risk required of each CSD, we believe it is forced to be undertaken 'to the extent possible' in the same way as Principle 19, because there are a multitude of different laws, structures and market practices applicable to the relationships between links, direct and indirect participants (including FMIs) and others. So we think that Principle 20 should include the expression of such extent.

ENDS

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