

International Organization of Securities Commissions (IOSCO)

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Dear Sirs,

The Royal Bank of Scotland Group plc (RBS) welcomes the opportunity to comment on the CPSS-IOSCO consultative report on 'Principles for financial market infrastructures'. RBS fully shares the CPSS-IOSCO overall objective of limiting systemic risk through the use of stable, robust and well governed financial market infrastructures, and in general supports most of the proposed principles developed by CPSS-IOSCO as set out in the consultative report.

We would like to make a number of remarks which we have divided into 2 sections:

- General remarks not specific to any particular part of the report
- Specific remarks on individual principles.

General Remarks

Whilst it is recognised that many of the principles are common to all FMIs, RBS is of the opinion that overall the unified approach lacks the clarity and segmented application to individual infrastructures offered by the original separate sets of standards. A clear distinction on how to apply the individual principles separately to payment and securities market infrastructures (where applicable) would help make the Principles clearer.

The increasing international and cross-border aspects of FMIs makes the correct and consistent application of the principles in the various jurisdictions essential. Apart from a level playing field perspective, alignment is also needed to make the application of the principles effective and workable.

Particularly within Europe, many payment systems are structured such that there is a separation between a scheme (typically responsible for setting the rules governing the participants and day to day operations) and the system itself (typically responsible for providing the underlying technical infrastructure). However, such separation of roles does not apply to all payment systems and the terms 'scheme' and 'system' may have different meanings in different contexts, particularly on a global level. It is recommended that the principles acknowledge and define such split roles.

Specific remarks on the individual principles

In terms of specific comments on individual Principles, RBS endorses the comments submitted by the EBF and AFME, and would like to make the additional comments below.

Principle 2: Governance

This principle is a broadening of the previous requirement that governance arrangements should be effective, accountable and transparent. The detailed guidance includes an explicit recommendation that Boards should ‘typically’ include independents – while accepting that may be appropriate in some cases, particularly for high-level strategic bodies, we do not believe that it will necessarily always be appropriate, for example where the Board in a user governed systems is focused primarily on detailed operational matters associated with provision of a resilient and cost-effective service.

Principle 4: Credit Risk

RBS agrees that different stress scenarios should be covered and believe the level of default considered to be the ‘worst-case scenario extreme but plausible market conditions (EBPMC)’ should be defined. We would like CPSS-IOSCO to carry out or commission and publish a detailed impact analysis, considering different scenarios by asset class/instrument and type of FMI, to help the market understand and agree on an appropriate basis for considering default impacts in a consistent way. In principle the default fund should be designed to be adequate to manage a default situation. We note that the impact on members may vary according to the FMIs management of the waterfall and/or whether or not the FMI has a segregated default fund and the asset class that is being centrally cleared. Should a CCP operate a single cross-instrument default fund we believe that in a default the risks should be properly allocated to the relevant clearing house members, i.e. the default waterfall should be allocated by instrument type. We suggest that CPSS-IOSCO should investigate the pros and cons of specific waterfall allocation and/or single default funds per instrument.

Principle 5: Collateral

The document refers to an FMI having appropriate legal and operational safeguards to ensure that it can use cross-border collateral in a timely manner.

We support the view that the use of cross-border collateral could provide an efficient liquidity bridge across markets, but believe the help of regulators and central banks is needed to ensure that cross-border collateral can in practice be used in a safe and timely matter (particularly under stressed conditions). We also suggest that there is a general requirement (not restricted to cross-border collateral) to ensure that collateral can be mobilised and has clear enforceability with respect to legal title.

RBS recognises that the intention of the overall principle is to specify inter alia that collateral should be highly liquid and thereby have low liquidity risk, and suggest that the wording should be adjusted to remove any possibility of ambiguity or misunderstanding.

Principle 6: Margin

We agree with this principle in general, but believe a clearer explanation of the cross-margining principles and the level to which risk management systems need to be harmonised is required.

Protection required for clients’ margin against the default of the FMI itself should be specifically referenced. We support the comments in section 3.6.4. However, it is not clear that exactly the same

provisions will work for non-centrally cleared instruments, and we suggest that further work is required on this aspect.

We disagree with the statements in 3.6.5. that although independent sources would be ‘preferable’ participant sources may be ‘sufficient’. We do not believe that a single participant is ever a sufficient source of price data for a clearable instrument; independent sources and independent price verification are always essential and should be among the requirements for making an instrument clearable.

With respect to section 3.6.8 we believe the wording should be revised to establish the principle that a CCP must disclose and make transparent to its participants all of its margin methodologies and data.

Principle 8: Settlement Finality

We believe that this principle provides a good minimum standard. We suggest CPSS-IOSCO could consider adding an aspirational target for settling intra-day or real time. We would also encourage CPSS-IOSCO to make a statement on the desirability of reaching global agreement on the definition of settlement finality. This is particularly necessary for the smooth operation of cross-border business. Next to the need to settle by the end of the value date, note should be taken of the key considerations for the low value, CSD or SSS FMIs to use multiple intraday batches or consider using RTGS.

Principle 10: Physical delivery

We endorse this principle, however with reference to page 58, where a statement is made on dematerialisation, would like to point out that an exception is needed for securities that are privately held or not publicly traded.

Principle 11: Central Securities Depositories

We take the view that a CSD should only be positioned as a utility. Therefore a CSD should focus on core activities related to its core function as central depository only. We believe that this principle should also apply to ICSDs, and that they should either be explicitly referred to here, or included within the CSD definition in the glossary to the document on p137.

We believe that CSDs’ ancillary functions should be separated from their core functions and suggest that the wording of the principle allows for this (P58, point 5) as we believe there should be legal separation of the ancillary activities of a CSD.

P60 – section 3.11.5 We support the segregation proposals. However, use of the segregation facilities should not be mandatory but subject to user choice, in consultation with the users’ underlying clients. Segregation by beneficial owner is not a protection against custody risk; there are other tools which provide this within omnibus account structures. Re the final sentence, we believe that CSDs should have insurance not just consider it.

Principle 12: Exchange-of-value settlement systems

We would suggest inserting a requirement that markets should strive for consistency; and the simultaneous fulfilment of their obligations, i.e. Model 1 (or at least Model 2), and we would like to see CPSS-IOSCO making a more definitive statement on the three models it defined in its document *Delivery versus payment in securities systems* of September 1992. We also suggest improving the definition of DVP in the glossary at p137 to include the notion of simultaneity, and the idea of moving towards Model 1/RTGS.

P62-63, section 3.12.4, *Timing of settlement*. We disagree with the second sentence: our view is that true DVP is simultaneous, and that this should be the aspiration of these principles that all markets should be striving towards, i.e. Model 1.

Principle 13: Participant default rules and procedures

There may be a need to review such procedures in the light of developments on Resolution and Recovery.

Principle 14: Segregation and Portability

It is important for CCPs and their regulators to consider the different risk profiles and requirements for the clearing of different instruments. We would recommend that the principles reflect the concept of considering different instruments' risk profiles.

Principle 15: General business risk

The proposed requirement on an FMI 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' raises the question as to what period of operating expenses should be so covered. In our view such a requirement should be able to take into account the implications of different ownership structures and the different levels of risk associated with these. In particular the requirement does not seem necessary in circumstances where the infrastructure is owned by the users as opposed to a third-party.

Principle 18: Access and Participation Requirements

The overall principle should state that access should be non-discriminatory at CCP, participant and asset class level. Contagion through co-mingling of asset classes should be avoided. We endorse these principles and believe they should all also explicitly apply to inter-FMI links. There should be fair and open criteria for FMIs to link to one another with reasonable risk management.

Principle 19: Tiered Participation Arrangements

We are concerned about the extent to which an FMI should be expected to interfere in the relationship between members and their customers, relationships on which it may well have no direct visibility. FMIs are not supervisors and should not be expected to become quasi-supervisors.

Principle 20: FMI Links

We fully support this principle, in particular item 3 in the key considerations that linked CSDs should measure, monitor and manage their risks arising from one another.

We note that the risks addressed should be considered as a matrix not simply a series of horizontal lines between FMIs performing services in the same service layer i.e. not only CSD-CSD and CCP-CCP. The same risk management criteria should be applied between layers (e.g. CCP-CSD; Exchange to CSD): all of the requirements should be applied between all FMIs and it should be made explicit that they do apply.

Principle 22: Communication procedures and standards

We support an obligation on FMIs to use or support international standards as opposed to proprietary standards (covering communications, messaging formats, and reference data) to facilitate interoperability and easy access, and reduce barriers to entry, in principle, provided that the reference to FMIs having an opt-out from having to use internationally accepted standards for purely domestic transactions is retained.

Principle 23: Disclosure of rules and procedures

While accepting the need to make information available to participants and prospective participants we have concerns about the requirement to make all information ‘publicly available’. As drafted the principle only permits details of business continuity arrangements and stress tests to be restricted to participants only. From the perspective of avoiding fraud or attempted fraud it is not desirable to publish detailed information on rules and procedures and descriptions of a system’s design and operations, this should be restricted to those with a legitimate interest i.e. members, prospective members etc. It is also unclear why information on fees and discounts needs to be publicly disclosed since these are fees paid by institutions to service providers and have at most a very indirect impact on the prices charged to end customers.

We would be pleased to discuss our views in more detail if required or if it would be helpful.

Yours sincerely,
Royal Bank of Scotland