

July 29th, 2011

Letter to be submitted by e-mail to cpss@bis.org, and fmi@iosco.org

Reference: BMV Group Post-trade Division response to Public Consultation on Principles for Financial Market Infrastructures, July 2011

Mr. Daniel Heller,
Head of Secretariat, CPSS
Mr. Masamichi Kono,
Chairman, IOSCO Technical Committee

Dear Mr. Heller and Mr. Kono,

BMV Group Post-trade division is grateful about the opportunity to comment on the consultative report on “Principles of Financial Market Infrastructures” (“Principles for FMIs”).

Let me put in context about the Financial Infrastructures we operate in Mexico. BMV Group Post-trade Division is the branch of BMV Group that is charged of processing and adding value until settlement for those trades performed at the Markets Division of the Group, that is, the equities and derivatives exchanges, the OTC Trading Platform for Bonds and Forex and other internal Mechanisms for registration of operations.

The Post-trade Division is integrated by a Central Securities Depository (Indeval¹) a CCP for Equities (CCV²) a Clearing House for Derivatives (Asigna³) a Price Vendor (Valmer⁴) and recently a Hub for Financial messaging (InterGloval). Some of the main services we provide are included: matching, novation, collateral and risk management, margination, fails processing, custody, securities (acting as SSS) and cash settlement (acting as PSS), corporate actions, valuation and financial messaging.

The entities involved directly with the proposed Principles as defined as Financial Infrastructures are CCV, Asigna and Indeval. The last, additional to its core function of Custody as a CSD, operates the biggest Payment System in Mexico, the Securities Settlement System and a mechanism for registration and tripartite collateral management for securities lending operations and

¹ www.indeval.com.mx

² www.contraparte-central.com.mx

³ www.asigna.com.mx

⁴ www.valmer.com.mx

repos. Asigna processes Futures, Options and Swaps contracts on a diversity of underlying assets, such as: indexes, currencies, interest rates. Finally, CCV has been novating equity trades since 2004.

Entities of this Division participate actively in a diversity of International Associations, Organizations and forums such as: CCP12⁵, ACSDA⁶, WFC⁷, ISSA⁸, SMPG⁹ and ANNA¹⁰, with the purpose of collaborating in the definition and adoption of best practices and standards for our industry. Actually the Division cooperated with ACSDA and CCP12 in the elaboration of their submissions to this Public Consultation. We agree with the majority of the views and concerns expressed within both responses.

In the case of CCP12 we share totally or partially with most of the Recommendations included in their submission. In a annexed section we're re-wording¹¹ those that we agree and in some cases applying slightly modifications in order to reflect the Division precise perspective. We're pointing-out for each Recommendation the considered key arguments.

Regarding our function of CSD, SSS and PSS, we are also fully supportive with the comments exposed by ACSDA in its submission.

The CPSS-IOSCO Proposal for FMI Principles

BMV Group Post-trade Division as a conglomerate of Infrastructures is grateful for opportunity to comment on FMI Principles. The effort of compiling the standards for Infrastructures makes sense since a core and common function for them, as systematically important entities is to contribute to the stability of financial markets. However, we should recognize the challenge to implement those Principles in our Industry, since each one of them applies in a different way to each type of the FMIs and that Organizations around the world are sometimes substantially diverse in: market protocols, local legislation and regulatory expectations, payment, trading and settlement systems with which the CCP interacts, product coverage, nature of the contractual obligations (e.g. relationship with the end user/client), nature of the business (listed/mutualised/vertical/horizontal), type, size and members/participants, etc.

In our opinion, even if FMIs performed very well during the last Global Financial Crisis (GFC), some substantial lessons to the effective risk management can be identified and should be turned on form of new standards

⁵ The Global Association of Central Counterparties

⁶ Americas Central Securities Depository Association

⁷ World Forum of CSDs

⁸ International Securities Services Association

⁹ Securities Markets Practice Group

¹⁰ Association of National Numbering Agencies

¹¹ We declare that for any case that the wording match with CCP12s submission one, the credit is wholly on its own

and / or some others to be revised or raised. On this, we share the general concern about a lack of an impact analysis that clarifies about the potential unintended consequences of the raising of individual standards. We shall remember that some of them (Credit, Liquidity and Business Risk) may require additional liquid resources and that this is asked in a context that markets are tried to be incentivized to be users of formal sound Infrastructures; for example G20 recommends OTC Derivatives trades to be cleared through a CCP. Costs are unavoidable to be transferred to end users and FMIs by increasing excessively their capital and liquidity demands, which can threat for these lasts their business viability, therefore for market efficiency and greater risk concentration.

We consider that the Assessment Criteria plays a complementary role; however it's a key factor for a successful instrumentation and fulfilment of the objectives for which the Principles were conceived, since it offers additional guidance to the standard adopting. We are keen to further discuss and cooperate while we're inviting CPSS-IOSCO to issue a Public Consultation, as soon as possible, to this Assessment Criteria. To avoid regulatory arbitrage by uniforming criteria among regulators will be crucial when Principles become mandatory standards and FMIs are assessed.

We sincerely hope that you will find this contribution helpful to accomplish the objectives of enhancement and reinforcement of the stability in financial markets.

Yours

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CRO BMV Group Post-trade Division

Cc. Gerardo Gamboa Ortiz, CEO; Luis Jorge Pelayo Camacho, Vicepresident Risk and Collateral Management

Annex: BMV Group Post-trade Division Recommendations shared (partially/totally) with CCP12

GENERAL

1. BMV Group Post-trade Division is keen to establish the assessment criteria and recommends that the Principles and Key Considerations that should be regarded as minimum international standards should be clearly specified in the document. The Explanatory Notes should provide background and guidance to best practice, but should not form part of the standards to which CCPs must adhere to demonstrate compliance.

- The wide diversity of appropriate FMIs model makes it very difficult to create a generic approach, so minimum international standards are necessary to have a common reference.
- There will always remain a need for national discretion to reflect local market characteristics and jurisdictional issues so these minimum standards are able to be increased / complemented, if an only of Regulators observe, as possible a generic and uniform criteria.

2. BMV Group Post-trade Division believes it is very important to ensure feedback has been received from market users, especially Clearing Participants, before implementing the Principles and urges CPSS-IOSCO to finalise and public consult the assessment criteria.

- Many of the market users have understandably been focussed on direct regulatory changes impacting the financial sector and have therefore spent little time considering the impact of these Principles.
- The cost of compliance with the raised standards is likely to be borne by market users
- FMIs have needed several months to assess the cumulative impact of the proposal and have only relatively recently been able to share their findings with their stakeholders

3. In order to assist FMIs explain the basis for the proposed changes and the resulting impacts to their market users, CPSS-IOSCO should provide a detailed rationale for each higher or additional standard.

- It is not always clear why a particular standard has been proposed in the absence of specific commentary for some proposed changes
- It has been difficult to explain the reason for the impact on/to market users

4. We are broadly in agreement with the following Principles:

- 10) Physical deliveries
- 16) Custody and investment risk
- 20) FMI links
- 21) Efficiency and effectiveness
- 22) Communication procedures and standards
- 23) Disclosure of rules and procedures

5. Independent validation to the extent proposed in Principles is not appropriate. Validation should be focussed on critical processes. This function should not be limited to independent expertise when there exists internal capability for this activity and where CCPs and Regulators estimate appropriate

- The need for external validation of any specific item is not uniform and should be at the discretion of the CCP or when agreed between the CCP and its domestic regulator.
- Given the inherent expertise within the organisations, the CCP and the regulators will provide sufficient oversight without the need to revert to external guidance.
- In some cases where an independent view is seen as beneficial, an internal review by another department of the CCP, e.g. internal audit, would be equally appropriate.

LEGAL

6. BMV Group strongly oppose the need to routinely obtain independent legal advice to support each aspect of its activities. Use of independent legal advice should be reserved for key contentious issues as determined by CCPs in consultation with their national regulator.

- Independent legal advice should be targeted at specific issues where either the CCPs or national regulators have identified a legal risk on which additional independent input is beneficial.
- On most issues, CCPs and regulators will already have the legal expertise to form opinions on the legal robustness of a CCP / CSD activities.

GOVERNANCE

7. BMV Group sees no reason as to why the majority of the membership of CCP Risk Committees should be limited to the organisation's Board members. We are however, fully supportive of Risk Management Governance principles listed in paras 3.2.11 and 3.2.12.

- Whilst not suggesting that drawing Risk Committee members solely from the Board is not an appropriate governance structure, we're unsure of the benefit of restricting committee members in this way.
- We consider that the use of external experts and/or customers in this role is highly beneficial.

8. Although CCP's should and do support, where practical, the risk management activities of their Participants, it is not the role of a CCP to perform those tasks on behalf of the Participant.

- We recognise the benefits of well risk managed Clearing Participants and understand that it is in the interests of CCPs and the markets which they serve to support Clearing Participant risk management activities where possible.
- CCPs, need to primarily focus on their own risk mitigation practices.

CREDIT

9. BMV Group Post-trade Division believe that the principles should explicitly state that the results arising from stress testing using the most extreme theoretical scenarios, not observed in the appropriate historical data, should be used for informational purposes only.

- Extreme theoretical scenarios, which are not observed in historic data, may provide valuable information to assist risk understanding and may help fine tune other risk quantification models.
- However, it is important that there is no expectation that CCPs are required to maintain risk resources against such possible losses.

10. Close out periods for margining should be based on normal market liquidity conditions, not those that may occur in a stressed market environment.

- **This also ensures consistency with the proposed objectives of margining which is to estimate potential close out losses in 'normal market conditions' as defined by the minimum confidence interval of 99%**

11. BMV Group seek to prevent negative procyclical impacts where possible, but the Principles should explicitly recognise that CCPs primary systemic risk protection is to maintain its own robustness and therefore set margin rates/collateral haircuts at a level that is appropriate for current market volatility.

- While CCPs are mindful of the impact to the wider market from their risk management activities, the best way for CCPs to promote systemic stability is to undertake actions which ensure their own solvency.

12. When determining the level of stress testing severity, BMV Group Post-trade Division believe that CCPs need only consider observed stress moves that occurred during periods where the prevailing market structure at the time is similar to the current market structure in which the CCP is now operating.

- It is important that CCP stress testing scenarios reflect the price behaviour of the markets currently cleared by the CCP.
- CCPs must avoid using excessive price moves on the basis that such moves have been seen historically but in markets that bear little relation

COLLATERAL

13. Acceptance of contingent assets as eligible collateral at a CCP, such as bank guarantees/letters of credit, should continue to be permitted within appropriate limits and supported by robust monitoring procedures, as determined by the respective CCPs and their local regulators.

- The importance of the diversity of collateral should not be underestimated nor where there are direct links between the exposure arising from open positions and the collateral held.
- However, it is important for the risk associated with each collateral type to be monitored and where appropriate subject to limits. In certain cases, such as the issuer being related to the Clearing Participant, prohibition is appropriate but CCPs should be able to determine their own policy in relation to contingent assets as eligible collateral in consultation with their home regulator.

SETTLEMENT FINALITY

14. Delivery failures to CCPs are an inevitable characteristic of settlement systems and should be explicitly recognised in the Principles. In addition, during default events, CCPs must be able to provide for Rule and Procedures to reschedule payments/settlements as an important risk management measure to alleviate liquidity pressures and ensure the viability of the CCP, particularly in situations where heightened systemic risk is evident.

- when combined with the liquidity stress testing requirements as having the most wide-ranging impact of all of the changes proposed in the document. Currently the standards are not totally clear with the definition of the term 'trade date' being critical to the meaning and purpose of this section. Informal discussions with national regulators

have also shown a variance in interpretation of the proposed standards.

- The most conservative interpretation of the text suggests that both delivery fails and rescheduled settlements are prohibited in all circumstances. As a result, CCPs/CSDs would need to 'buy in' ahead or on the morning of the scheduled settlement date to ensure that all deliveries are made.
- The ability to reschedule settlements of a defaulting participant in the most severe circumstances is an important option for a CCP in managing a default. In order to limit the potential liquidity contagion

PARTICIPANT DEFAULT

15. CCPs must retain flexibility in their default management activities.

- It is important that CCPs retain the flexibility achieved through their wide-ranging Rulebook powers that provide them with the capability of applying the optimum approach to the particular circumstances of any default.

SEGREGATION AND PORTABILITY

16. BMV Group Post-trade Division urges CPSS-IOSCO to carefully consider the commercial impact and potential unintended consequences on CCP users of portability requirements where the CCP is required to each hold Clearing Participant's client margin, on a gross basis, at the CCP.

- Segregation and especially portability requires national law changes.
- In order to guarantee legal certainty with regard to segregation and portability arrangements, different national laws for all relevant jurisdictions urgently need to be aligned.
- The objective to improve position portability as a way of improving default management capabilities in the event of a Clearing Participant default is positive.
- To achieve this objective, portability could only practically be achieved through gross margining of client.

17. The Principles should also recognise that portability of a significant number of retail client positions may be impractical in the necessary timescales for a CCP's management of a default.

- Clearing Participants engaged in cash market trading often have a significant number of retail client positions. Given the substantial

number of transactions and short settlement timescales, transferring typically T+3 unsettled transactions is not practical for a CCP.

GENERAL BUSINESS RISK

18. Proposed general business risk methodology of 6,9 or 12 months should not be limitative and national regulators should be permitted to determine appropriate amounts based on the CCPs approved internal models.

- The objective of holding capital against general business risks is positive but it's necessary to consider that such approach does not properly reflect the cost of winding down a CCP business. Many CCPs already employ their own models for 'non-default' capital requirements and these should be reviewed by the relevant regulatory authority. Where approved, the results could be used to determine the appropriate capital requirement.
- In the absence of such models, CCPs requirements should be based on six months of operating expenses.

TIERED PARTICIPATION

19. BMV Group Post-trade Division believes that the ability of CCPs to review risks associated with indirect participants and participant's default capabilities is impractical.

- The expectation of reviewing the potential risks arising from indirect participation and also of the CCP having adequate information of direct members' default handling process to deal with the default of indirect participation would be very onerous and probably impractical.
- It is therefore suggested that compliance requirement with this principle should have adequate flexibility.
- Further clarity is also sought from the purpose, scope and requirements of this principle.