The voice of banking
& financial services

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Dear Sirs 21 July 2011

Subject: CPSS-IOSCO Principles for Financial Market Infrastructures' Consultation

The BBA welcomes the opportunity to comment on the Committee on Payment and Settlement Systems (CPSS)-International Organization of Securities Commissions (IOSCO) Principles for Financial market Infrastructures consultation. The BBA has seen and contributed to the response submitted by the European Banking Federation (EBF) and fully supports the content of that submission except where indicated below. We also tender several additional points for consideration.

The British Bankers' Association (BBA) is the leading association for the UK banking and financial services sector, speaking for over 200 banking members from 60 countries on the full range of UK and international banking issues. In addition, 40 professional firms are also associated with us. Our members, whilst predominately banks, engage in activities which range widely across the financial spectrum, encompassing services and products as diverse as primary and secondary securities trading, insurance, investment advice and wealth management, custody, as well as conventional and non-conventional forms of banking.

Balance and implementation

As financial market participants (FMPs) in financial market infrastructures (FMIs), the BBA supports the CPSS-IOSCO public policy objectives of:

a) enhancing the safety and efficiency of FMIs;
b) limiting systemic risk; and
c) fostering transparency and financial stability.

Industry supports the development of a regulatory system which aligns with these principles as they are fundamental to FMIs which are both stable and drivers of economic growth. To this end, the financial services sector has invested significant energy and resources into reforming the FMIs space since the onset of the crisis, an effort which has been acknowledged by regulatory authorities across several jurisdictions. Accordingly, the BBA supports the development and implementation of policies which continues this work and implements of the above objectives.

Given the systemic nature of many FMIs and the central role they play in financial markets, policies which implement these principles must strike a right balance between preserving the financial markets' stability, ensuring a fair competition among FMIs and allowing access to FMPs and their clients. It is important to note that financial market infrastructures performed soundly during the recent economic crisis and there were few significant infrastructure failings which induced wider systemic risks. While this is not a reason to disregard reform in this area, a lack of an adequate balance between safety and efficiency may create distortions that could potentially lead to increased risks in the financial system and damage economic growth.

It is crucial that any regulatory initiatives which arise from these principles are developed, implemented and enforced equally across *all* jurisdictions. Furthermore, it is essential that the principles for FMIs are fully consistent and coherent with existing legislation and that which is currently being developed in Europe, in the United States or elsewhere. Authorities globally *must* coordinate their efforts when developing and implementing policies based on the CPSS-IOSCO principles, especially in view of the increasingly transnational nature of FMIs.

Risk Committee (principle 2)

The BBA believes there is a very clear need for a CSD to have a robust and proactive risk committee. CSDs can and – in the case of ICSDS - do take on substantial non-operational risk, especially when they provide services such as credit, deposit taking, securities lending etc. Accordingly, the scope of risk committee's activities should reflect these wider non-operational factors. Even for those CSDs who provide only core settlement and safekeeping functions, the risks related thereto are substantial and warrant a risk committee in which participants are actively represented.

Liquidity and collateral (principles 4, 5 & 7)

As mentioned above, one of the major factors in the crisis was not a systemic failure of FMIs but the loss of liquidity in the market. Ample market liquidity is also crucial if a financial system is to enable and drive economic growth during normal market conditions. As such, the BBA is concerned that these principles give insufficient regard to their impact on market liquidity and their potential effect on growth. Whilst locking up liquidity in FMIs may result in greater financial stability and more robust infrastructures, it may also have adverse consequences for profit generating market making activities. This is particularly so when they are seen within a wider regulatory context, namely the general regulatory shift towards the greater use of collateralisation as a means of ensuring FMI stability.

The higher demand for collateral that the principles demand may also have a negative impact on small and medium enterprises (SMEs). While financial institutions which do not operate any central system or perform any core function are excluded from the scope of the CPSS-IOSCO principles, FMIs' participants and participants' clients will have to adapt to more stringent user requirements. Where a participant is an SME, the risk of not being able to access financial markets due to prohibitive access conditions or because financial institutions may not have sufficient capital to fund them as these institutions themselves may face higher collateral requirements.

When the CPSS-IOSCO principles are considered in aggregate and in conjunction with other regulatory developments such as Basel III, the most likely scenario is that they will have a constraining effect on wider market liquidity. This will require financial institutions to raise additional capital which could lead to a scarcity in collateral. In such a scenario, it is plausible that only the largest institutions will be able to access sufficient collateral to participate in some FMIs. Furthermore, as collateral will be tied up in market infrastructures, it will not be available for financing the activities of the wider economy and contributing to economic growth.

Despite these challenges, it is crucial that collateralisation standards are not relaxed. The BBA believes that it is vital for the stability of the financial system that FMIs implement strict discipline around the collateral they accept and that these standards are applied robustly across all jurisdictions. Eligible collateral should present low credit, liquidity and market risk, as appropriate to the risks inherent in the relevant FMI to ensure its proper and continued functioning.

Proposals are on the table for banks to hold more and better quality liquidity, as per Basel III and CRD IV, and possibly hold in regional hubs, and guidance on liquidity swaps, between banks and insurers, is being consulted on by the FSA. Therefore, other measures ought to be considered to avoid trapped pools of liquidity and the disruption of liquidity allocation.

FMI access to central bank liquidity (principle 7)

The BBA believes that the role of central banks in providing liquidity during a crisis to central counterparties (CCPs) should be addressed. Specifically, where an FMI is a CCP, the BBA believes that the principles should clearly state that CCP must have sufficient liquidity for emergency situations and not manage its liquidity with the assumption that a central bank will step in and provide support. This is reflected in the recent comments of central bankers from both the ECB and the Bank of England who have recently stressed the need for central banks to retain their independence of action and not be bound to provide this type of assistance.

The BBA believes that in the event that such assistance is provided, it should be specified that the central bank in question would not necessarily have to be the central bank of issue. If this were not the case, some jurisdictions may specify that such facilities are only available to entities in the same currency zone, making it impossible for CCPs clearing a range of currencies (which LCH.Clearnet and other UK CCPs do) to obtain facilities from all relevant central banks.

Gold plating and applicability

The BBA supports the EBF's contention that the explicit language within the CPSS-IOSCO's principles concerning the issue of gold-plating (i.e. "*authorities have the flexibility to consider imposing higher requirements for FMIs")*, should be removed. The BBA shares the view that neither global financial stability nor investor confidence will be served by the possible co-existence of differing regulatory frameworks applicable to the same FMIs. This added of complexity will increase compliance costs, raise investment barriers and create real market distortions.

The BBA welcomes CPSS-IOSCO's recognition of the general and specific applicability of its principles. Indeed, some CPSS-IOSCO's principles are only relevant to certain FMIs. The BBA joins with the EBF in highlighting that it is not necessarily the licensing regime that determines whether a principle should be applicable but, rather, the fundamental functions and responsibilities of a given FMI. The text should be amended to influence implementing policies accordingly.

Similarly, the BBA shares the EBF's observation that the new principles lack the clarity and the segmented application to individual infrastructures offered by the original three separate sets of standards from which it draws. The report should be amended to unambiguously recognize that different types of FMIs have distinctive characteristics. While we do not provide any specific suggestions on how this should be done, any redrafting should be clear and concise to limit the potential disparities in implementation.

Data

The BBA stresses that data which is reported to trade repositories is for compliance purposes alone and not for public consumption. This information is centralised for use by regulators to monitor and assess systemic risk, etc. This information is confidential and commercially sensitive. Even aggregated, anonymous data should be strictly controlled. The principles should be amended to reflect this condition.

I remain at your disposal should you wish to discuss this response.

Yours sincerely,

AJRogan

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