

We would like to thank you for the opportunity to give feedback on the proposed new, harmonised CPSS-IOSCO Principles for Financial Market Infrastructures. The Dutch market has discussed the new Principles in a meeting on 30 June. The comments below however represent only the view of De Nederlandsche Bank.

Credit and liquidity risk (Principles 4 and 7)

DNB feels that there should be a level playing field with regard to the requirements for Central Counterparties (CCPs) on credit and liquidity risk. The new European legislation EMIR imposes for credit risk (in article 40, 2a) on CCPs the requirement to be able to withstand the default of the largest participant or the second and third largest participants combined. For liquidity risk the requirement in EMIR is based on withstanding the default of the two largest participants (article 41a). In view of consistency it would therefore be logical to “raise the bar” in the CPSS-IOSCO Principles and set the requirements in Principle 4 Credit Risk and Principle 7 Liquidity Risk on “cover two”. Also, CCPs that are active globally seek the same rules globally. Europe will set the standard on “cover two” in EMIR. We understand that the CFTC also uses the criterion of “cover two” for their systemically important systems (non-systemically important systems need to comply with “cover one”). The CPSS-IOSCO paper suggests that all CCPs are systemically important and will then have to comply with “cover two” anyway. In view of consistency it makes sense to use the same criterion (“cover two”) for both credit and liquidity risk.

It is not entirely clear to DNB what is meant by “potential future exposure”. This is important to determine how much the CCP should cover. In the same manner: what is considered ‘extreme but plausible’ circumstances (for stress testing)? This will always be a subjective outcome.

We would like to remark that for payment systems things work a bit differently. The participants run risks on each other instead of on the FMI (except where commercial banks step in). EBA Clearing for instance bears no credit risk, only the participants have credit risk on each other. The definition for liquidity risk is different on the payment side than on the CCP side and credit risk is not really an issue on the payment side.

It is recommended to have a clear split between the margin requirements and what the CCP should be able to cover with it, and on the other hand the stress tests, its principles and what it aims to cover. Also, a clear split is needed between stress testing and back testing. It is suggested in the Principles (3.6.14) that back tests are based on theoretical models, but this should not be the case. Back tests are performed on real data to test the validity of the models.

Settlement finality (Principle 8)

DNB continues to support the principle that settlement finality should occur by the end of the value day. We would however also support a (new) Principle on 'early settlement', i.e. settlement as early on the intended settlement date as possible. It is felt that, because there is no clear owner of settlement (in) efficiency, a Principle along these lines could help lower the number of settlement fails.

Money settlement (settlement in Central Bank Money, Principle 9).

Access to CeBM for CCPs is an issue and should be addressed properly. The still increasing level of international consolidation (at the trade level) could make it more difficult to have access to and settlement in CeBM.

Central Securities Depositories (Principle 11)

We would like to point out that the responsibility for the integrity for the issue should be more explicitly attributed to the CSD. It is felt that 'to help ensure' is a too weak formulation.

The second point we would like to raise with regard to this Principle is that (future) EU legislation/regulation on CSDs makes reference to core and non-core functions of the CSD. Harmonisation between the new Principles and legislation/regulation would be favourable.

Segregation and portability (Principle 14)

DNB embraces the idea, but remarks that it is rather hard to achieve in practice. Especially so for the clearing of equities, because of the Finality rules. After matching, an instruction is irrevocable and can no longer be withdrawn from the system. Unless both instructions are withdrawn, but that is something that the defaulting participants will most likely not (be able to) do.

From a legal perspective, this could be considered a dead letter (as it is in EMIR). The law applicable to CCPs is different from the law applicable to its participants. If the law applicable to participants does not arrange for segregation, then the assets will fall in the bankrupt estate of the participant anyway and segregation on the level of the CCP will not be of any use.

Another remark relates to margin financing by banks. Margins on the various exchanges can be offset, but with segregation the possibilities for this offsetting will decrease. It diminishes the possibilities for traders and leads to less liquidity. Is this consequence considered by CPSS-IOSCO?

Not every CCP will be able to offer this, it depends on the jurisdiction of the CCP whether it is legally possible. First, there will have to be a legal level playing field.

General business risk (Principle 15)

The period (in terms of number of months) to be used depends on the type of business, ownership structure, risks and the ease of rerouting traffic onto other channels. Clearing of derivatives is more complex, a longer “wind down” period is therefore needed and hence a larger buffer. It is implied that there needs to be at least two CCPs for each asset class, otherwise switching in the short term will not be possible. Is this the CPSS-IOSCO intention? As to the period needed, DNB prefers a period of 9 to 12 months. This is to ensure that there is sufficient buffer within the institution and the capital reserves will never fall below the 6 months period.

There are some questions on the concept of affiliates. In the CPSS-IOSCO Principles the affiliates are taken into account, in EMIR they're not. Further, it needs to be precised what is an affiliate, when is it included in default calculations, can regulators apply their own interpretation of affiliates?

It is not clearly defined exactly what poses a business risk. Does it stem from internal decision making (an investment gone wrong) or does it include external developments, e.g. loss of business because of competition? The question is for what kind of events should assets be available?

Operational risk (Principle 17)

DNB observes that this Principle does not single out 'business continuity management' as a discipline in its own right. We suggest having an explicit mentioning of BCM as part of this principle instead of BCM for separate elements of the Principle.

Regarding the need for a secondary site, this should only apply for critical services, not for all services provided by an FMI.

The requirement to resume operations within two hours should be explained: what does that mean if the incident occurs less than two hours before normal closing hours of the system. Though seemingly not fitting within the context of principle based regulation, DNB supports the creation of a certain minimum level here. Also it is suggested to address roles and responsibilities of other stakeholders -i.e. linked FMIs – in relation to the recovery objectives of a single FMI.

Tiered participation arrangements (Principle 18, 19)

We would like to flag the practical difficulties in monitoring the indirect participants' situation and performance. There is no certainty that this Principle can be complied with in practice. Also, this Principle would certainly lead to an increase in the cost base of the FMI, because new policies, systems and procedures would have to be developed.

The focal point for an FMI is on the principal-to-principal relationship. Indirect participants of an FMI are not the primary focus. We would like express doubts about the usefulness of Principle 19. The distribution of risks and efficiency of an FMI are more important drivers for participation. General information about

indirect customers would be helpful, but not from the point of view of risk-management. The Know-your-customer-principle is only applied to the GCMs as direct participants which are mostly entities under supervision. Monitoring of indirect participants would also become too costly. Portability of positions from an FMI is not decisive for monitoring indirect participants.

Links (Principle 20)

The lack of interoperability in the context of securities systems, e.g. between CCPs, does not hamper opportunities for consolidation which is mainly driven by user-demand. The key for interoperability lies in the relationship of the FMI with other CCPs and/or trading platforms (trade feeds) i.e. a bidirectional link between CCPs should be accompanied by a trade feed from the respective exchange or MTF to both linked CCPs .