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Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 5000 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU only.

Comments by the European Banking Federation (EBF) on the CPSS-IOSCO consultative report "Principles for financial market infrastructures"

Key points

- **As financial market participants (both direct and indirect) in financial market infrastructures (here and after FMIs), European banks support the objectives set forth by the CPSS-IOSCO principles** of enhancing the safety and efficiency of FMIs, limiting systemic risk and fostering transparency and financial stability.

- Because **FMIs play a central role in financial markets, their robustness and soundness is crucial for ensuring a smooth functioning of financial markets in all conditions,** even the most stressful ones. Only adequately designed and operated FMIs may prevent financial shocks from being passed from one participant or system on to another. Proper and effective regulation of FMIs is, therefore, instrumental in instilling confidence that securities and payments infrastructures can withstand the most severe shocks.

- **Given the systemic nature of many FMIs,** the EBF believes that the principles should strike a right balance between preserving financial markets' stability, ensuring a fair competition between them and allowing access to financial market participants and their clients on the basis of **stable and robust risk management frameworks.**

- The EBF stresses that **consistent implementation of the CPSS-IOSCO principles at national level is of utmost importance,** not only for ensuring a level playing field, but above all for preserving the soundness and stability of the FMIs themselves and of capital markets at a global level.

- Therefore, the EBF would recommend that CPSS-IOSCO **consider the work that has been carried out in various regions of the world if these principles are to be applied at a global level.** Neither global financial stability nor investor confidence will be served by the complexity resulting from the possible co-existence of differing regulatory frameworks applicable to FMIs.

- The EBF is nevertheless **concerned by the extensive supervisory role allocated to FMIs in certain circumstances** (e.g. tiered participation arrangements) which may result in an inappropriate power given to FMIs to interfere in a commercial relationship between members and their customers. The Federation is of the opinion that **FMIs are not supervisors and should not be expected to become quasi-supervisors.**

- Finally, while the EBF recognises that many of the principles are common to all FMIs, the Federation invites CPSS-IOSCO to better acknowledge that different types of FMIs have distinctive characteristics. **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.**

General remarks

The EBF welcomes the opportunity to comment on the CPSS-IOSCO consultative report on "Principles for financial market infrastructures". The comments that the Federation would like to share have been prepared by different work streams within the EBF involving experts from both the payment and securities side. The EBF refers to the note produced by the **TARGET Working Group** (TWG) for more detailed comments concerning payment systems. In addition, the EBF, as a constituent member, supports the submission by the **International Banking Federation** (IBFed) which represents banking associations worldwide.

As a preliminary remark, the EBF would like to underscore that its comments are written from the perspective of **participants (both direct and indirect) in financial market infrastructures (here and after FMIs).**

As financial market participants in FMIs, **European banks share the CPSS- IOSCO public policy objectives** of (i) enhancing the safety and efficiency of FMIs; (ii) limiting systemic risk; and (iii) fostering transparency and financial stability. Financial market participants better fulfill their economic and societal role in stable financial markets. **Only adequately designed and operated FMIs may prevent financial shocks** from being passed from one participant or system on to another.

Given the systemic nature of many FMIs, and the **central role they play in financial markets,** the **EBF believes that the principles should strike a right balance** between preserving financial markets' stability, ensuring a fair competition among FMIs and allowing access to financial market participants and their clients. The lack of an adequate balance between safety and efficiency may also create distorsions that could potentially lead to increased risks in the financial system.

The EBF supports that **public policy action is taken to ensure the full achievement of the above-mentioned objectives**. That said, the Federation would like to remind that the financial services industry has invested significant energy and resources in better organising the FMIs space since the beginning of the crisis. Such efforts have been recognised by the Financial Stability Board (FSB) and other regional public authorities such as the European Commission and the Federal Reserve Bank of New York, particularly in the area of OTC derivatives clearing.

In this respect, the EBF believes that it is essential that the principles for FMIs are **fully consistent and coherent with legislations that have been or are being developed** in this field in Europe, in the United States or elsewhere if these principles are to be applied at a global level. Alignment cross-jurisdictions as regards the application of the principles is needed considering the increasing international and cross border aspects of FMIs.

While the EBF has sympathy for the CPSS-IOSCO approach of presenting a set of principles that is broad in its scope and is agnostic as to the concrete tools required to satisfy them, the Federation considers that CPSS-IOSCO's explicit language over the possibility of gold-plating (i.e. "*authorities have the flexibility to consider imposing higher requirements for FMIs*", page 12 of the consultative report) should be removed. The **EBF is of the view that neither global financial stability nor investor confidence will be served by the complexity resulting from the possible co-existence of differing regulatory frameworks** applicable to FMIs.

The EBF welcomes CPSS-IOSCO's language about general and specific applicability of its principles. Indeed, some CPSS-IOSCO's principles are only relevant to certain FMIs. The Federation would like to note, however, that **it is not necessarily the licensing regime (i.e. the type of FMI) that determines whether a principle should be applicable** but, rather, the functions and responsibilities of any given FMI. For example, principle 24 on disclosure of market data is of application to Trade Repositories only, according to the CPSS-IOSCO document. There are, however, other FMIs (e.g. central counterparties) that could meet - partially or in full - the information needs of participants, authorities and the public.

Similarly, while the EBF recognises that many of the CPSS-IOSCO principles are common to all FMIs, we nevertheless believe that the report lacks the clarity and the segmented application to individual infrastructure(s) offered by the original three separate sets of standards. The Federation therefore believes that the report needs to **acknowledge more overtly that different types of FMIs have distinctive characteristics.** There are various ways of achieving such segmentation but we believe it needs to be done in a structured way rather than suddenly referring to a specific type of FMI in the middle of the text. For example, one option could be to group common features and key considerations under each principle but then add further short sections covering aspects relating to an FMI(s) which have characteristics not applicable to all FMIs.

With regard to the implementation of the principles, the EBF agrees that, **whilst a degree of self-assessment by FMIs is desirable, relevant authorities are expected to regulate and supervise FMIs consistently with the principles**. In this regard, as stated in the report, international coordination is of utmost importance, to avoid potential duplications.

The EBF also understands that financial institutions, that do not operate any central system or perform any core function, and have only bilateral and commercial relationships with their customers, are excluded from the scope of the CPSS-IOSCO principles. These principles therefore focus on infrastructures performing central functions to the market. However, as a result of the implementation of these principles, **FMIs' participants and participants' clients will also have to adapt to more stringent requirements,** be they retail financial institutions, corporates or SMEs. The risk for this latter category of clients is to be simply left out of financial markets due to prohibitive access conditions or because financial institutions may not have sufficient capital to fund them as these institutions may face higher collateral requirements.

This higher demand for collateral that will be required from financial institutions by clearing, settlement and payment infrastructures, at a time when Basel III will require financial institutions to raise additional capital, may **lead to a scarcity in collateral,** leaving possibly only the largest institutions to access sufficient collateral. Furthermore, as collateral will be blocked in market infrastructures, it will **not be available for financing the economy** in a time where some regions would need all financing means available to sustain their growth.

Finally, the EBF would like to underscore the need to embark on as **broad and thorough a reflection as possible to consider the overall impact that the implementation of these principles may have on the levels of market liquidity**. Whilst tying up liquidity in certain FMIs such as CCPs may be positive for financial stability or prudential supervision approaches, it may have adverse consequences for market making activities and/or efficient collateral management.

Specific remarks on the individual principles

General organisation

Principle 1: Legal basis

> An FMI should have a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.

The EBF concurs with CPSS-IOSCO that **a legal framework that protects participants and participant's costumers of an FMI from the latter's insolvency is of the essence.** Besides the need for segregation and portability rules as defined in principle 14, we believe that the increasing international and cross-border aspects of FMIs make it essential to guarantee across jurisdictions the ownership rights for any investor over the financial instrument credited on its account.

As a general principle, the EBF is in the opinion that the **applicable law** governing the rights and interests in a financial instrument, settlement finality and netting **should be defined with respect to the localisation of the account** where the relevant financial instrument is registered, like provided for in the European Union (EU) by the Settlement Finality Directive and the Financial Collateral Directive.

As regards conflict of law issues (3.1.10), it should be stated clearly that **the choice of law cannot be an option for the determination of the law applicable to the system** and the proprietary aspects of securities held on a participant's account in the system.

Furthermore, the Federation would recommend a **stringent regulatory approach regarding possible other services** offered by FMIs, that are not performed in support of their core services, as these are likely to involve additional risks.

Finally, the EBF fully agrees with the recommendation to **eliminate the "zero-hour rules"** as these may give rise to credit and liquidity risks. But for clarity, it is suggested that the phrase *"zero-hour rules should be eliminated"* is amended to read *"zero-hour rules should be eliminated by the appropriate authorities"* (3.1.6). The intention is of course to make it clear that such elimination may well not be within the power of the FMI.

Principle 2: Governance

An FMI should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders.

The EBF welcomes the explicit recommendation that "*the board should ensure that the FMI's overall strategy, rules, and major decisions reflect appropriately the interests of its participants".* There is uncertainty however, as to how the above recommendation may be fulfilled if the board *"typically"* includes independent members, as also recommended by the principle on governance.

Broadly speaking, the **Federation is concerned that the interests of participants in the FMI may be simply addressed along with those of other stakeholders**. The recommendation that "*mechanisms for involving stakeholders in the board's decision-making process* <u>*may*</u> (our underlining) *include user representation on the board, user committees, and public consultation processes*" seems to be worryingly pointing in that direction.

It should be recalled that, in certain FMIs (e.g. central counterparties), participants ultimately bear the default risk of the infrastructure. Therefore, it is the view of the Federation that **there should be a clearer, more direct link between "*financial support*" and "*voice/representation*".** Similarly, while it is essential that a CCP has a risk committee, the EBF finds it inappropriate that such a risk committee *"should be chaired by an (...) independent board member"* as this does not adequately reflect the risk borne by the clearing members.

Furthermore, the EBF would like to underscore its support to CPSS-IOSCO as it notes that **an FMI providing services that present a distinct risk profile from its core functions should ensure that adequate legal and/or governance arrangement are in place to prevent possible conflict of interests and risk propagation.**

On a more technical level, the EBF also considers that the validation by an FMI, on an ongoing basis, of the models and the methodologies it uses to quantify, aggregate and manage its risks is of outmost importance. We therefore believe that **the process of model validation should involve supervisory authorities.** Concretely, supervisors should have the power to assess the adequacy of the models to the general objectives pursued by an FMI (as referred in principle 1 on legal basis) as it is already the case for credit institutions.

Finally, regarding systemically important payment systems (SIPSs), we would suggest **to make a clear distinction between SIPSs and other FMIs in terms of governance.** The governance of SIPSs is generally handled by the banking industry (e.g. CLS, HVPS, ACHs), or the central banks (for RTGS). In Europe, SIPSs are only open to credit institutions because of the Settlement Finality Directive.

Principle 3: Framework for the comprehensive management of risks

An FMI should have a sound risk-management framework for comprehensively managing legal, credit, liquidity, operational, and other risks.

The EBF agrees that an FMI should take an integrated and comprehensive view of its risks, including the risks it bears from and poses to its participants and their customers. The Federation backs the recommendation that **an FMI should manage risks from a comprehensive perspective and have a sound risk-management framework.**

The Federation wonders, however, if, as primarily risk mitigating infrastructures, FMIs should not pay more attention to the risks that they can absorb from the market (and less to the risks that they pose on participants). Whilst it is true that FMIs pose risks to participants and to the wider system as a whole, the **EBF does not consider that the provision of incentives for participants and other interdependent entities to identify, measure, and manage their own risks should be one of the tasks of FMIs**.

<u>Credit and liquidity risk management</u>

Principle 4 and 7: Credit and liquidity risks

Principle 4: Credit risk An FMI should effectively measure, monitor, and manage its credit risk from participants and from its payment, clearing, and settlement processes. An FMI should maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. A CCP should also maintain additional financial resources to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the [one/ two] participant[s] and [its/their] affiliates that would potentially cause the largest aggregate credit exposure[s] in extreme but plausible market conditions.

Principle 7: Liquidity risk

An FMI should effectively measure, monitor, and manage its liquidity risk. An FMI should maintain sufficient liquid resources to effect same-day and, where appropriate, intraday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of [one/two] participant[s] and [its/their] affiliates that would generate the largest aggregate liquidity need in extreme but plausible market conditions.

The EBF is of the view that an FMI should be required to apply **stable and robust risk management** policies based on its risk profile (which may differ depending on whether the FMI is a CCP, a CSD or a payment infrastructure)**,** while supervisors should carry out intensive and efficient oversight functions, so as to avoid that an FMI can face the possibility to be liquidated.

The Federation agrees with the definition of credit risk and liquidity risk provided by CPSS-IOSCO and underlines the importance of the *"high degree of confidence"* between direct participants, indirect participants and FMIs in the risk coverage process. **An FMI's transparency towards its direct participants is of the essence on stress scenarios, assumptions and methodologies.**

Furthermore, the EBF considers that, in order to be efficient, regulation determining an FMI's additional financial resources (i.e. beyond initial capital) needs to take into account the diversity of profiles of credit risks among traded products (traditional futures or derivatives), payment services offered (cash clearing) as well as the difference between markets (in terms of concentration).

Finally, as regards liquidity risk management, the EBF believes that, subject to the conditions listed below, **the cover one scenario should be the minimum requirement for payment systems.** A major reason for this is the likely limit on the availability of suitable collateral which may also be required for a range of other purposes including Basel regulatory requirements, monetary policy operations and other FMIs. The concern we have is that stipulating a minimum cover two requirement could result in some institutions relying on other participants' liquidity by delaying outward payments which would not only reduce operational efficiency but also potentially create additional risk for the other participants who may effectively be acting as unsecured liquidity providers. However, this proposal is **subject to the following three conditions:**

- Group situations where participants are financially linked are treated as one participant for this purpose and the phrase *"participant and its affiliates"* is not considered sufficiently explicit. Instead, it should be replaced with more formal group criteria, possibly based on Basel principles. It follows that several participants (and their affiliates) may be counted as a single entity for cover one purposes.
- When applying this requirement, it must be possible for payment systems to measure and control the highest intra-day credit risk, where applicable, and this requirement should be

applied to such risk. For DNS systems, the term "intra-day" should be construed as being the highest credit risk arising during the deferred settlement process based on the underlying legal infrastructure. It is acknowledged that some payment systems may require time to accommodate this requirement but it is considered important that the underlying principle should be established.

- Robust default procedures, including where two or more participants fail simultaneously, with mandatory testing at least annually and more frequently if material changes are made, should be put in place so that in a crisis situation they can be implemented without delay.

Principle 5: Collateral

An FMI that requires collateral to manage its or its participants' credit risk should accept collateral with low credit, liquidity, and market risk. An FMI should also set and enforce appropriately conservative haircuts and concentration limits.

Considering the increasing scarcity of available collateral, the EBF considers that **an FMI should dynamically adjust its requirements for acceptable collateral,** in accordance with changes in underlying risks.

The EBF notes that, in a situation of market stress, any given FMI's survival reflex may enter intro contradiction with the preservation of wider market stability. For that reason, the Federation strongly supports the recommendation that **FMIs should have in place an appropriate collateralisation policy that reduces to the maximum extent possible haircuts** that can have a pro-cyclical impact on the market.

Furthermore, as regards the reference made to the use of cross-border collateral to provide an efficient liquidity bridge across markets, the EBF would like to emphasise that **an FMI should have the proper legal and operational safeguard to ensure it can use the cross-border collateral** in a timely manner and that the FMI should consider Foreign Exchange-related risk.

Principle 6: Margin

A CCP should cover its credit exposures to its participants for all products through an effective margin system that is risk-based and regularly reviewed.

The EBF broadly supports this principle. The Federation believes however that **margins should first and foremost be calculated and used to cover day-to-day activities.** Margin coverage in the key consideration 6 seems referring to testing in period of stress while in fact margin coverage is used to monitor normal conditions, not stress scenarios. This is what is provided for in the future EMIR (see Article 39 of the initial European Commission's proposal). Assessing margins in case of stress scenario should only be a tool to help improve the definition and use of margins, but it should not serve as a basis for the actual definition and calculation of margins.

Furthermore, the distinction between the initial margin and the default fund does not clearly appear through the wording of the first consideration.

Finally, **cross-margining principles are not clear** in key consideration 5. This is allowed if two CCPs completely understand each other's risk management practices and financial resources and harmonise their overall-risk management systems.

Settlement

Principle 8: Settlement finality

> An FMI should provide clear and certain final settlement, at a minimum, by the end of the value date. Where necessary or preferable, an FMI should provide final settlement intraday or in real time.

The EBF fully supports this principle and believes that **settlement finality is a major component of systemic stability and should therefore be guaranteed.** Finality comes at the very end of the settlement process and it ensures the certainty of the ability to use, for any possible purpose, the cash and securities liberated by the finalisation of the settlement of a trade. The principle is already applied in the EU through the Settlement Finality Directive.

While the EBF agrees that intraday or real time settlement is *"preferable"* to end of value date settlement, in order to reduce settlement risk, the Federation encourages CPSS-IOSCO to consider adding a **target of settling intraday or in real time.**

Regarding the issue of the links between CSDs (see also principle 20), the EBF stresses that **there should only be one system providing settlement finality for any transaction.** This seems not to be addressed in the consultative report and the Federation invites CPSS-IOSCO to complement the report in this direction. Similarly, the existence of conditional finality throughout linked systems may increase systemic risk, by submitting participants to several domestic markets to unexpected unwinding of settlement with the risk of a domino effect.

Finally, in the explanatory note 3.8.6 ("Revocation of transfer instructions"), the words *"or discourage"* should be deleted as settlement rules should be clearly defined, in particular where a stress situation occurs.

Principle 9: Money settlements

> An FMI should conduct its money settlements in central bank money where practical and available. If central bank money is not used, an FMI should minimise and strictly control the credit and liquidity risk arising from the use of commercial bank money.

Generally speaking, the EBF believes that **settlement in central bank money is preferable where available,** especially in stress situation, but it should remain possible to settle in commercial bank money, provided that exposure is properly managed, or to use a combination of central bank and commercial bank monies, as it emerges from the explanatory note to the principle. Ideally, the use of central bank or commercial bank monies should be decided according to market demand.

As regards settlement on the books of an FMI (3.9.6.), the EBF points out that **an FMI established as a *"special-purpose institution"* that provides banking-type services that are not performed in support of the core activities of the FMI should be required to hold a banking license and be subject to prudential supervision**.

Principle 10: Physical deliveries

An FMI should clearly state its obligations with respect to the delivery of physical instruments or commodities and should identify, monitor, and manage the risks associated with such physical deliveries.

The EBF supports this principle.

<u>Central securities depositories and exchange-of-value settlement systems</u>

Principle 11: Central securities depositories

A CSD should have appropriate rules and procedures to help ensure the integrity of securities issues and minimise and manage the risks associated with the safekeeping and transfer of securities. A CSD should maintain securities in an immobilised or dematerialised form for their transfer by book entry.

The EBF believes that **the role of a CSD is to perform core functions which are essential to the stability and efficiency of capital markets** and ultimately to the safeguard of the interests of the securities' issuers and holders. These core functions are registration, central safekeeping and central settlement. If and when a CSD was to conduct other activities, these activities should have a clear connection with the core services (e.g. the administration of corporate actions) and must be low-risk, i.e. they should not create additional risk over and above the standard operational risk associated to the core functions above mentioned.

Would a CSD decide to perform other services that are not related to the provision of core services and that could bear credit or liquidity risk, **these services should be clearly disconnected and segregated from the provision of core services** and be subject to a separate (usually banking) license and to the related (usually prudential) rules, in particular for the authorisation and supervision.

The EBF therefore shares the view of CPSS-IOSCO that additional tools may be necessary to address the credit and liquidity risks associated to the provision of services that are not linked to the core functions of a CSD, or that a CSD may need to separate legally the other activities it may perform along its core functions in order to mitigate possible additional risks. The Federation believes that a **clear line of demarcation between the market infrastructure's role and core functions of a CSD and the higher-risk other services it may perform as a distinct**

commercial entity is essential in order to prevent that the credit or liquidity risks associated to these separate commercial activities spills over into the core functions of a CSD, possibly bringing new systemic risk and instability into the broader financial market.

For instance, a CSD should only act as a lending agent due to the significant risk, pointed out in the consultative report, that it could be exposed to when acting as principal in a security lending transaction.

The EBF also notes that section 3.44.5 on "Segregation of assets" is to some extent unclear. The EBF fully agrees that a CSD should protect against custody risk, but would like to stress that **a full segregation of securities** (i.e. a segregation by final beneficiary at the level of the CSD) **is not an appropriate or an adequate response to custody risk,** and is in contradiction to principle 18 which supports fair and open access to FMIs.

The EBF believes that it is absolutely the case that (i) a CSD should segregate its own assets from participant assets, and (ii) a CSD should allow its participants to segregate in the books of the CSD (participant) proprietary assets from assets of clients of the participant. However, CSDs cannot by themselves protect their participants from custody risk that has its origin in an inappropriate domestic legal environment. Furthermore, the EBF believes that daily reconciliation of the securities issues that a CSD maintains provides a good minimum standard. We would however suggest that CPSS-IOSCO encourage CSDs to go beyond that minimum standard especially when final settlement occurs on a real time basis.

Finally, the EBF believes that principle 11 should also apply to ICSDs and so they should either be explicitly alluded to here, or included within the CSD definition in the glossary to the document (p. 137).

Principle 12: Exchange-of-value settlement systems

If an FMI settles transactions that involve the settlement of two linked obligations (for example, securities or foreign exchange transactions), it should eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other.

The EBF supports this principle.

<u>Default management</u>

Principle 13: Participant-default rules and procedures

An FMI should have effective and clearly defined rules and procedures to manage a participant default that ensure that the FMI can take timely action to contain losses and liquidity pressures, and continue to meet its obligations.

The EBF agrees that continued operability of an FMI in distressed situations is of the utmost importance and, therefore, backs that FMIs have access to additional resources (e.g. the default fund or the FMI's own funds). It is, however, important that the **scenarios and conditions for using those resources (e.g. waterfall mechanisms) are clearly defined**. In this respect, we encourage CPSS-IOSCO to refer to the default waterfall mechanism agreed upon in the European Market Infrastructure Regulation (Article 42 of the initial European Commission's proposal for EMIR).

In order to rationalise access to additional resources, **an FMI** is expected to remain vigilant on the financial condition of its participants and, in that regard, it **should promptly inform the competent authority where it considers that a participant may default.** The EBF therefore suggests aligning on the future EMIR and including a provision that a CCP *"shall promptly inform the competent authority where it considers that a clearing member will not be able to meet its future obligations and before it declares its default"* (Article 45 EMIR). Early warning should permit a timelier handling of potential conflicts between the interests of the infrastructure and the interests of the market as a whole.

Principle 14: Segregation and portability

A CCP should have rules and procedures that enable the segregation and portability of positions and collateral belonging to customers of a participant.

The EBF agrees that the segregation of indirect participants' positions and collateral plays an important part in the safe and effective holding and transfer of their assets. **Effective segregation arrangements can reduce the impact of a participant's insolvency on its customers.**

The Federation reminds that, in its December 2010 consultative document on "Capitalisation of bank exposures to central counterparties", the Basel Committee proposed a favourable treatment for "bankruptcy-remote" collateral for direct participants as well as a favourable qualifying CCP risk weight for non-member banks exposures, provided their assets were segregated and bankruptcy-remote from the direct participants.

The Federation considers that under the proposed principle 14 on segregation and portability, **segregation should not be a universal requirement, and if mandated, should depend upon how bankruptcy-remote the CCP is.** When arranged at the request of the participant, acting on behalf of its customer, segregation should be conditional on a specific instruction of the latter to make use of this facility and the provision of sufficient details in the trade instruction to the CCP to identify the underlying customer.

Finally, the EBF is agnostic as to the presented models for segregation of assets and margins. From a general standpoint, however, the Federation considers that **an ideal model would be one that fully protects the positions of indirect clearing members on their request, allows an expedite portability, and provides full transparency to the participants on their exposures.**

General business and operational risk management

Principle 15: General business risk

An FMI should identify, monitor, and manage its general business risk and hold sufficiently liquid net assets funded by equity to cover potential general business losses so that it can continue providing services as a going concern. This amount should at all times be sufficient to ensure an orderly wind-down or reorganisation of the FMI's critical operations and services over an appropriate time period.

While the EBF sees the policy rationale of covering all kinds of potential risks an FMI could face and understands the proposal that an FMI should hold sufficient equity capital to cover potential general business losses so that it can continue providing services as a going concern or achieving an orderly liquidation, we observe that **the capital requirements associated with the introduction of this new category of risk may entail higher fees for the use of FMIs,** as it is likely that the cost of additional capital buffer will ultimately be borne by the users of FMIs. In order to avoid a general increase in the fees and the costs related to the implementation of this principle, the EBF would prefer that FMIs are required to have sound and prudent business models, to apply robust risk management policies, while supervisors should carry out intensive and efficient oversight functions, so as to avoid that FMIs can face the possibility to be liquidated.

The EBF also asks as to what period of operating expenses should be covered. This requirement does not appear to take properly into account different ownership structures and the different levels of risk these bring to the system. In particular this requirement does not seem appropriate in situations where the infrastructure is owned by the users as opposed to third-parties. In view of the short term nature of payment systems settlement, **six months operating expenses are considered acceptable for payment systems** in order to have sufficient time to make alternative arrangements.

Finally, notwithstanding the description given here and the remarks made by CPSS-IOSCO in the cover note to the consultative report, it is suggested that **a formal definition of equity capital should be provided.** Also, it is unclear why holdings of liquid net assets need necessarily be funded by equity in the case of payment systems provided that such assets are ring- fenced and specifically dedicated to this purpose.

Principle 16: Custody and investment risk

> An FMI should safeguard its assets and minimise the risk of loss or delay in access to those assets, including assets posted by its participants. An FMI's investments should be in instruments with minimal credit, market, and liquidity risks.

The EBF supports the provisions on custody and investment risk, in particular the requirement for an FMI to safeguard its assets in supervised and regulated entities that have robust accounting practices and safekeeping procedures.

While the EBF agrees that an FMI should have an easy and prompt access to its assets and that its investment strategy should be consistent with its overall risk-management strategy, we would welcome **more clarity on what constitutes the investment strategy of an FMI** in terms of criteria and procedure.

Furthermore, the EBF emphasises the limited applicability of this new principle in the context of the growing demand for collateral. The issue when using a commercial bank as custodian is that the assets held under custody are guaranteed to a specific threshold which is not relevant for the amounts posted for collateral or margin purposes. The participant may get back the assets it has posted in the books of the defaulting bank but has no certainty whether it would receive the whole amount or not.

Finally, financial markets being global and FMIs more and more interoperable, safeguarding FMIs' assets and those of their participants is crucial for securing financial stability. Against this background, regulators should be particularly vigilant in **ensuring that assets are protected at all times on a global scale irrespective of the jurisdiction where they are posted.**

Principle 17: Operational risk

> An FMI should identify all plausible sources of operational risk, both internal and external, and minimise their impact through the deployment of appropriate systems, controls, and procedures. Systems should ensure a high degree of security and operational reliability, and have adequate, scalable capacity. Business continuity plans should aim for timely recovery of operations and fulfilment of the FMI's obligations, including in the event of a wide-scale disruption.

The EBF supports the principle that an FMI should establish a **robust operational risk-management framework** that should allow complete and rapid identification, monitoring, management and prevention of operational risk. The EBF reminds however that the rulemaking of this principle should be tailored to the specific needs of each type of FMI. Appropriate systems, policies, procedures and controls to minimise operational risk should also be **made fully available to all FMIs' participants** (in their capacity as users of infrastructures) to ensure transparency in risk management.

The EBF would however suggest requesting an FMI to **have a clear and precise classification of the operational risks** it may encounter in the conduct of its activities. In order to facilitate the identification of risk and foster the prevention of it, an FMI could be encouraged to put in place a system of identification of operational risks. Such a system could be composed of (at least) two levels of risk management: first, the management of minor but more frequent errors; second, the management of more serious and disruptive events. Each kind of operational risk should be addressed by specific requirements that would be defined according to the nature and relevance of the risk concerned.

The EBF particularly welcomes the provision on business continuity planning that we regard as extremely important and necessary so as to ensure that an FMI is able to carry on its functions in all circumstances. The Federation however stresses that **in case of operational problems, the participants of an FMI are the first to be impacted.** Therefore, we would welcome a requirement on FMIs to inform their participants of any operational failure which they may experience. This would enable participants to adopt internal appropriate measures to cope with the situation as soon as possible. Such an obligation could take the form of time and communication requirements.

Finally, **regular testing is of such crucial importance** that it is suggested that a maximum period between major tests should be stipulated e.g. the FMI must operate from its back-up site for at least a full business day including any associated night-time processing during a 12 month period based on the assumption that the primary site has been destroyed and no personnel or records have survived including top management.

Principle 18: Access and participation requirements

An FMI should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access.

The EBF agrees with CPSS-IOSCO that an **FMI should permit participants fair and open access to its services**. Access to an FMI cannot, however, be indiscriminate: **participants in an FMI should also be subject to certain objective risk-based requirements** to ensure they do not pose a risk to the efficient and safe functioning of an FMI.

Furthermore, it is suggested to add a second sentence to the principle which would read as follows: *"Where appropriate under local law and/or regulation, these should be subject to competition law approval".* In the context of the European single market, it is indeed crucial that these access rights are harmonised within the EU, which is not the case today.

Finally, the EBF reminds CPPS-IOSCO of the importance to address exit procedure with clear criteria, the adherence to which should be closely monitored by competent authorities. **Exit criteria should be clearly spelled out** and take into due consideration the impact that the exit of a large market participant could have on an FMI’s stability. Rules on asset segregation are thus instrumental in providing safety to the non defaulting members (principle 14). Supervisory authorities should resort to all available tools to preserve the stability of an FMI in case of rumors on the possible exit of a participant in an FMI.

Principle 19: Tiered participation arrangements

An FMI should, to the extent practicable, identify, understand, and manage the risks to it arising from tiered participation arrangements.

The EBF agrees in principle with CPSS-IOSCO that an FMI should try to identify, understand and manage the risks arising from tiered participation arrangements.

The EBF nevertheless points out that this principle could be very **difficult to implement.** Most CSDs for instance operate omnibus accounts and are not in a position to identify their clients' customers. Furthermore, FMIs are not supervisors and should not become so. The Federation believes that the issue is less about granting an FMI powers that are inherent to supervisors, but rather to require the latter to set objective criteria on tiered participation arrangements and a clear allocation of responsibilities between FMIs and supervisory authorities.

The Federation therefore invites CPSS-IOSCO to **involve local regulatory authorities in the supervision process of the criteria and procedures defined by an FMI to manage risks arising from tiered participants.** We believe it is crucial for the FMI but also for the local supervisor to have a clear vision of the risk arising from tiered participants and to be able to identify the source of such risk.

The involvement of the regulator is also particularly important in the default procedures of an indirect participant (3.19.6). In particular, we note that the phrasing *"to the extent practicable"* can lead to misunderstandings or different interpretations. Consequently, the EBF invites CPSS-IOSCO to provide more clarity on the procedures an FMI would be expected to put in place to face a default of an indirect participant.

Generally speaking, the EBF is **concerned by the extent an FMI can or should try to interfere in a commercial relationship between one of its members and its customers,** relationship of which it may well have no direct visibility. Confidentiality rules and/or competitive concerns might also prevent a financial institution to disclose to an FMI relevant data on clients' clients. For all these reasons, **the EBF would therefore oppose conferring discretionary supervisory power to an FMI which would go beyond its direct participants and would include end-investors.**

Principle 20: FMI links

An FMI that establishes a link with one or more FMIs should identify, monitor, and manage link-related risks.

The EBF assumes that the links between FMIs refer to the concept of interoperability. The EBF does not oppose the development of interoperability arrangements. **In the case of CCP links, interoperability arrangements should only apply to cash securities** European banks have nevertheless continuously stressed that it is of absolute necessity to have clear, strict, sound and robust risk management rules for the establishment of such arrangements.

The EBF shares the view of CPSS-IOSCO that mandatory clearing will increase the use of CCPs and that **links between CCPs will create additional operational and financial risks.** One of the most visible consequences of the greater use of CCPs is the concentration of risk in one type of infrastructure. If mandatory clearing increases the number of links between FMIs in general and CCPs in particular, as suggested in the cover note to the consultative report, the EBF would then recommend that links between CCPs be subject to particular supervision to prevent risk propagation.

We indeed believe that an excessive number of links between interconnected CCPs, with some of them becoming useless or inactive, could indeed potentially lead to a market paralysis which could thus increase the level of systemic risk and therefore lead to an opposite result in terms of risk mitigation. Links between trading venues and CCPs or CSDs and links between CCPs and CSDs bear in principle less risk as long as the operational flow of information is ensured.

Furthermore, the EBF stresses that FMIs should not be competing on the basis of risk management standards. Their risk management arrangements should be subject to regulatory approval and be published to participants. In particular **cross-border FMI links should be subject to close supervision by competent authorities.** In this respect, any memorandum of understanding establishing cross border links should obey to close supervisory requirements and should be based on equivalence recognition, to the extent possible.

Finally, the EBF recalls that there should only be one system providing settlement finality for any transaction operated via links (see our comments to principle 8).

Efficiency

Principle 21: Efficiency and effectiveness

An FMI should be efficient and effective in meeting the requirements of its participants and the markets it serves.

The EBF supports this principle.

Principle 22: Communications procedures and standards

An FMI should use or accommodate the relevant internationally accepted communication procedures and standards in order to facilitate efficient recording, payment, clearing, and settlement across systems.

The EBF generally supports this principle but would recommend **keeping communication protocols and standards at a scheme level and not at a messaging level.** As far as communication protocols and networks are concerned, we also believe it is essential that regulators worldwide can check and ensure that there is a **level playing field,** also in terms of oversight, between the different solutions offered to market participants.

Transparency

Principle 23: Disclosure of rules and key procedures

An FMI should have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks they incur by participating in the FMI. All relevant rules and key procedures should be publicly disclosed.

The EBF backs the principle that an FMI should provide sufficient information to its participants and prospective participants to enable them to identify clearly and understand fully the risks and responsibilities of participating in the system. Such principle should, however, be subject to the following **limitation**: **detailed information on an FMI's rules and procedures and/or a description of a system's design and operations** that may compromise the infrastructure's safety and integrity (risk of fraud or attempted fraud), or may contain commercially sensitive information, should not be disclosed to parties with no legitimate interest in it. It is therefore suggested to add: *"except where such disclosure may risk prejudicing the security and integrity of the system or divulging commercially sensitive information"* to the sentence *"All relevant rules and key procedures should be publicly disclosed"*.

Furthermore, public disclosure is referred to in various parts of the consultative report with various qualifications but it is considered important that care is taken throughout the report to **ensure that neither safety nor integrity are compromised and commercially sensitive information is safeguarded.**

Finally, the EBF calls regulators worldwide to ensure that there is a **level-playing field** when implementing this principle so that all relevant communication shall be available without discrimination to market participants.

Principle 24: Disclosure of market data

A TR should provide timely and accurate data to relevant authorities and the public in line with their respective needs.

While the EBF fully supports the provision of timely and accurate data by Trade Repositories (TRs) to relevant public authorities, **effective access by the public to the data recorded in TRs must be assessed carefully** in the context of the impact this may have on market liquidity. Therefore, even if only aggregated breakdowns and anonymous data are being provided, the phrase "*as available and appropriate to the public*" (3.24.2) should be stressed and duly considered when seeking for greater transparency to the broader public.

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