JASDEC DVP Clearing Corporation
July 29, 2011

Committee on Payment and Settlement Systems
International Organization of Securities Commissions

Comments on the CPSS/IOSCO Consultative report, *Principles for Financial Market Infrastructures*

1. Introduction

JASDEC DVP Clearing Corporation (JDCC) is a clearing house for transactions in financial products, authorized by the Prime Minister under the Financial Instruments and Exchange Act. Since May 17, 2004 JDCC has functioned as a financial products clearing institution to undertake clearing services for DVP settlement services for non-exchange transaction deliveries handled by JASDEC[1].

This document contains our comments on the CPSS/IOSCO consultative report, Principles for Financial Market Infrastructures, that was released on March 11, 2011. We would like to express our gratitude for being given the opportunity to participate in the consulting process.

At JDCC, we greatly respect the continuous efforts being made by CPSS-IOSCO to contribute to financial market stability. We sincerely hope that this consultative process and subsequent investigations will result in the development of sound financial market infrastructure principles and further improvements in clearing and settlement stability and efficiency.

2. Specific comments

<u>Introduction</u>

(1.30.)

We believe that the ‘Key questions’ and ‘Assessment methodology’ could have a significant impact on each FMI’s application of the *Principles for Financial Market Infrastructures*. Moreover, in these revised *Principles* a number of new items have been included. Accordingly, the ‘Key questions’ and ‘Assessment methodology’ should be included in the market consultation process.

1 JDCC is a wholly owned subsidiary of JASDEC.

Principle 2: Governance

(3.2.9.) (3.2.12.)

Our understanding is that this principle, rather than proposing a specific governance structure, permits diverse governance arrangements depending on factors such as regulations in different countries and the ownership structure and organizational form of each FMI.

However, some items in this principle, such as 3.2.12., do not appear to allow a diversity of approaches, so we think that these items need to state that a variety of governance approaches will be acceptable.

In support of this, for example, a number of different governance systems could be enumerated; or, if it proves difficult to include such descriptions, the aim and intent of the governance principles could be clarified, along with examples of undesirable structures or particular governance methods that should be avoided.

Principle 3: Framework for the comprehensive management of risks

(Key consideration 2) (3.3.2.) (3.3.4.)

This principle places obligations on FMIs not only for their participants but also for participants' customers. We think that the uniform application of this obligation, even to FMIs that do not have any direct relationship with participants' customers, will give rise to situations that diverge considerably from the current operations of FMIs and the rules and regulations relating to FMIs.

Accordingly, we believe that further careful deliberation is required if this section is to be incorporated into the principles. And if it is incorporated, it should be made clear that the approach can be tailored to the actual circumstances of each FMI, by using terminology such as, "…participants and (if applicable) their customers…"

Principle 7: Liquidity Risk

The intent of including affiliates as well as participants is presumably based on the idea that there is a high probability of simultaneous default, but if we look at past examples there does not seem to be a high enough incidence of this to warrant this kind of uniform application.

There is also the question, on the one hand, of how many participants (either one or two) to include in the requirements for liquid resources. On the other hand, if all affiliates are uniformly included, it would expand the liquid resource requirements beyond that required to cover the two participants deemed to have the largest aggregate liquidity needs, which we believe would lead to an excessive burden. Accordingly, we believe that the treatment of affiliates should be decided on the probability of simultaneous default rather than on a blanket basis.

Principle 13: Participant-default rules and procedures

A number of matters are raised in 3.13.1.(b), which covers 'customers of the defaulting participant', 3.13.2.(e), which covers 'the expected treatment of proprietary and customer transactions and accounts', 3.13.4. and 3.13.6.(c), which cover the 'customer position', and 3.13.6.(e) which covers 'the mechanisms to help address the defaulting participant's obligations to its customers.'

With different regulatory environments and operations undertaken in each country, there are some FMIs that do not have any direct relationship with participants' customers. We therefore think that all sections referring to 'customers' should be adjusted to include terminology meaning 'if such direct relationship exists'.

Principle 14: Segregation and portability

The transaction details of derivative transactions are not defined simply by the fact of having taken a position. Rather, they are defined by reverse trades during some discretionary period in the future, or by final settlement on a fixed date, or by the exercising of certain rights. Accordingly, enforcing a compulsory closing out of the positions of participants' customers in the event of participant default will result in customers losing the right to undertake the aforementioned reverse trades and suchlike. For this reason, it is necessary to establish a system to transfer interests. Further, in order to enable the transfer of interests, it is necessary to administer margin money separately. Because of this, our understanding with regard to derivative transactions is that systems for the transfer of interests and separate money management need to be established.

With cash transactions, meanwhile, the transactions details are defined at agreed stages, so systems for the transfer of interests and separate money management are not necessary in the way they are with derivative transactions. Also, the settlement period is short (in Japan, T+3 settlement), which means that even if account transfers were to be implemented, it would be difficult for the relevant parties to secure the necessary time. (In our organization, obligation is assumed on the settlement date, so time constraints would make it particularly difficult.) Further, at CCPs where some kind of netting method is used for cash transactions, separate money management could impede the netting process, and by extension could have a significant operational impact in terms of increasing exposure or increasing collateral calls.

Additionally, with regard to segregation, Japan's Financial Instruments and Exchange Act includes provision for the separate management of customers' assets, and this can be seen as sufficient in itself to achieve the aim of protecting customers' assets.

In light of these factors, our view is that the need for segregation and portability differs according to the items being cleared by CCPs, so this should be incorporated into the principle.

Principle 15: General business risk

In 3.15.8. it states that FMIs are required to establish a business reorganization plan. However, business reorganization plans lack specificity and effectiveness unless they are formulated at the stage when they have become necessary. For this reason we think it is unrealistic to require the establishment of reorganization plans when businesses are in a sound condition.

There is also a requirement to establish a business wind-down plan. Under Japanese regulations, however, there are circumstances in which the cessation or dissolution of an FMI's business requires the permission of the regulators , due to the need to ensure stability in securities settlement. (For clearing institutions, the relevant item of the Financial Instruments and Exchange Act is Article 156-18.) Under this system, we envisage that the business wind-down of an FMI would take place in a way that avoids systemic disruption, and that it is not necessary for the principle to require the development of a wind-down plan while businesses are in a sound state.

Principle 19: Tiered participation arrangements

Our understanding is that this principle says that FMIs are required, to the extent practicable, to identify, understand and manage potential risks arising from tiered participation arrangements. However, in 3.19.5. it states that an FMI should ensure that its rules, agreements and procedures with direct participants allow it to gather basic information about indirect participants, and note 117 states that an FMI may be able to obtain this information through its internal systems or by requesting it from direct participants. Because of factors such as the absence of any contractual relationship between CCPs and indirect participants, we believe that it would not in reality be easy for an FMI to obtain information on indirect participants via direct participants. Accordingly, we would like this principle to be revised in a way that more closely reflects actual circumstances.

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