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Via electronic delivery
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Re: Consultative Report on Principles for Financial Market Infrastructures

Dear Sir or Madam:

The Clearing House Association L.L.C. ("**Association**") and The Clearing House Payments Company L.L.C. ("**PaymentsCo.**" and, together with the Association, "**The Clearing House**")[1] appreciate the opportunity to provide comments to the Committee on Payment and Settlement Systems of the Bank for International Settlements ("**CPSS**") and the Technical Committee of the International Organization of Securities Commissions ("**IOSCO**") in response to their consultative report on Principles for Financial Market Infrastructures ("**Consultative Report**"). Specifically, The Clearing House would like to address the portions of the Consultative Report that are stated to apply to systemically important payment systems ("**SIPS**").

[1] Established in 1853, The Clearing House is the nation's oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House Association is a nonpartisan advocacy organization representing through regulatory comment letters, amicus briefs, and white papers the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. See The Clearing House's web page at http://www.theclearinghouse.org for additional information.

Our comments are informed by our more than 40 years' experience in operating a large-value funds-transfer system. The Clearing House Interbank Payments System ("**CHIPS**") has been in operation since 1970 and currently processes more than US$1.6 trillion in payments on an average day. The Clearing House pioneered many of the techniques that later became standard risk-mitigation procedures for SIPS, including bilateral credit limits, sender net debit caps, and collateralized loss-sharing agreements. CHIPS is considered a SIPS under the Federal Reserve Board's policy on Payment System Risk and has been in compliance with the CPSS's Core Principles for Systemically Important Payment Systems ("**Core Principles**") since their adoption in 2001, as it was in compliance with the "Lamfalussy Standards" when they were adopted in 1990. We therefore have considerable experience not only in operating a SIPS but in meeting all applicable standards for the safe and sound operation of such a system.

I. EXECUTIVE SUMMARY

The Clearing House recognizes the systemic importance of certain large-value payment systems and the significant risks that they may pose to the financial system if they are not properly managed. The Clearing House therefore strongly supports CPSS and IOSCO's goal to update the standards applicable to financial market infrastructures ("**FMIs**"), such as SIPS, to ensure adequate risk management, to reflect the lessons learned from the recent financial crisis, and to ensure that SIPS and other FMIs understand their roles in the larger financial system and are operated in ways that will not compromise the stability of the financial markets. To assist with these goals, The Clearing House provides its comments and recommendations in response to the Consultative Report. Specifically, The Clearing House *recommends* that:

1. (General) The Principles should only apply to the extent proportionate and necessary to achieve effective oversight over each type of FMI. Duplication between Principles should be eliminated and useful portions of the Core Principles should be retained.

2. (Principle 1) An FMI's obligations to articulate its legal basis should be limited to the laws relevant to its activities as an FMI. Obligations to ensure enforceability of an FMI's rules on the insolvency of a participant or to obtain "well-reasoned legal opinions" may be disproportionate or unattainable and should be modified.

3. (Principle 2) Governance requirements should account for the different organizational structures of FMIs, particularly in relation to the appointment of "independent" board members and should apply to the designated FMI entity only.

4. (Principle 3) Proposed obligations to manage risks posed to an FMI by other entities may impose an excessive and potentially unattainable standard on SIPS. The scope of requirements to provide "incentives" and "capacity" should be clarified.

5. (Principles 4, 5, 7) Obligations relating to credit risk, liquidity risk, and collateral should only apply to FMIs that assume such risks.

6. (Principle 15) Obligations to achieve an "orderly wind-down" or "reorganisation" of an FMI should be commensurate with its risk profile. Obligations relating to asset and capital maintenance should reflect the specific organizational structure of an FMI.

7. (Principle 18) Requirements relating to access and participation should take full account of existing, equivalent obligations under national laws.

8. (Principle 19) The terms "tiered participation arrangements," "indirect participants," and "interdependent FMIs" should be more precisely defined. The scope of an FMI's obligations in relation to indirect and interdependent entities should be proportionate to the risks they pose.

9. (Principle 21) Some obligations in relation to efficiency and effectiveness may not be necessary for privately owned FMIs operating in competitive markets.

10. (Principle 22) The requirement to use "internationally accepted" communications procedures and standards should permit a sufficiently broad range of standards and procedures to continue to be used and should not mandate conformity with specific standards, such as SWIFT or ISO 20022.

11. (Principle 23) The requirement for public disclosure of an FMI's rules and procedures should be limited to the extent necessary to achieve effective risk management and tailored to the individual circumstances of each type of FMI.

We provide further detail on each of the above points below.

II. PRELIMINARY REMARKS

The Principles should only apply to the extent proportionate and necessary to achieve effective oversight over each type of FMI. Duplication between Principles should be eliminated and useful portions of the Core Principles should be retained.

The Clearing House believes that certain proposals under the Consultative Report that would increase the formal regulatory obligations of FMIs are disproportionate and unnecessary to achieve the goals of harmonizing and, where appropriate, strengthening the existing international standards for systemically important FMIs. In particular, we note that the Consultative Report is presented as 24 “Principles” supported by "Key Considerations" and more detailed "Explanatory Notes." The Clearing House recommends that it should be fully clarified under the Consultative Report that while the Explanatory Notes provide general guidance on how the Principles may be implemented, they do not in themselves create regulatory imperatives for FMIs.

This clarification will ensure that the entities responsible for regulating FMIs, such as central banks and independent regulators, are able to implement the Principles in a flexible and reasonable manner that reflects both the local conditions as well as differences between FMIs, including different types of SIPS. With regard to SIPS specifically, the Consultative Report seems to envisage that an FMI is structured as a single legal entity with a board of directors as its governing body, whereas in practice they are configured in a variety of ways, for which this may not be the model. There should also be greater differentiation between private and publicly owned SIPS, where appropriate, as discussed further in section III, below.

In addition, we recommend that a standard of "reasonableness" should be included in each of the Principles (including the Key Considerations and Explanatory Notes) to ensure that they are applied in a way that is proportionate to the particular circumstances of the FMI in question. We support the limitation of the obligations under Key Consideration 1 of Principle 19 "to the extent practicable." The Clearing House also considers that certain portions of the Core Principles contain many useful details relating to SIPS that will facilitate the application and interpretation of the Principles and should be reinserted. These are highlighted in section III, below.

The Clearing House notes several instances of duplication or repetition between the Principles (including the Key Considerations and Explanatory Notes). We recommend that any such duplication or repetition should be eliminated in order to avoid ambiguity in their interpretation that may reduce their ability to achieve effective oversight over SIPS and other FMIs. We have noted instances of duplication between, *inter alia*: the obligation to monitor compliance with participation requirements under Principle 18 and monitoring and reporting requirements under Principle 1; disclosure obligations under Principle 2 (notably paragraph 3.2.15) and Principle 23; general risk-management obligations under Principle 2 (Key Consideration 5) and Principle 3, as well as their interaction with Principles 4, 5, and 7, as discussed in section III(B)(ii), below; in relation to interdependencies, Principles 17 (notably paragraph 3.17.16), 19, and 20 (although we note that Principle 20 does not apply to SIPS).

III. DETAILED COMMENTS

The Clearing House would like to make the following detailed comments and recommendations in response to specific principles proposed under the Consultative Report.

A. General Organization, Access, Efficiency, and Transparency Principles

The Clearing House welcomes measures designed to improve the governance of FMIs that will, *inter alia*, increase legal certainty, consistency, and transparency in the oversight of FMIs in order to promote their efficiency and support the stability of the broader financial system. We specifically comment on the following aspects of these Principles:

i. Principle 1: An FMI's obligations to articulate its legal basis should be limited to the laws relevant to its activities as an FMI. Obligations to ensure enforceability of

an FMI's rules on the insolvency of a participant or to obtain "well-reasoned legal opinions" may be disproportionate or unattainable and should be modified.

The Clearing House fully supports the need for an FMI to have a well-founded, clear, transparent, and enforceable legal basis for its activities in relevant jurisdictions that it is able to articulate to relevant parties. However, we recommend that an FMI's obligations in this respect should be clearly limited and applied only to those activities that it conducts in its capacity as an FMI. In particular, we recommend that the relevant "legal framework" for the purposes of articulating the legal basis should include only those laws that are relevant to the risks faced by FMIs as FMIs, the articulation of which is therefore important for facilitating sound and effective risk management by the FMI. For instance, we do not consider property and corporation laws to be sufficiently relevant to the activities of an FMI, acting as such, and would recommend that these be removed from the scope of the legal framework described in paragraph 3.1.2 of the Consultative Report.[2]

Similarly, the scope of references to "each aspect of its activities" and "all relevant jurisdictions" should be clearly defined, so as not to create unattainable or unnecessary obligations for FMIs. Therefore, it should be clearly stated that an FMI's "activities" are only those that it conducts in its capacity as an FMI and would exclude, for example, property leases or software license agreements that are only incidental to its activities as an FMI.

With respect to "relevant jurisdictions," we are particularly concerned to understand the scope of a SIPS' obligations in the context of cross-border funds transfers. It is clear that the laws of the jurisdiction in which a SIPS operates would regulate the obligations of the parties to the payment order processed by the SIPS. However, other legal regimes may also be engaged in a cross-border funds transfer, depending in particular on whether the receiver of the payment order is an intermediary bank or a beneficiary's bank. Given that there may be several intermediary banks involved, an obligation to articulate the legal basis in "all relevant jurisdictions," unless properly clarified, risks imposing an unreasonable investigatory burden on the SIPS and introducing legal uncertainty into the system.

The Clearing House is concerned that the recommendation to obtain well-reasoned and independent legal opinions or analyses as an approach to articulating the legal basis would impose an unduly expensive and time-consuming obligation on FMIs, particularly if the relevant legal framework, and therefore the scope of the legal opinion is not further restricted, as recommended above. Similarly, the reference to obtaining a "well-reasoned" opinion should be carefully delimited. In particular, the Principles should recognize the many practical limitations of legal opinions (namely, extensive assumptions and reservations, as well as limits on the persons who may rely on the opinion), which combined with the high

[2] Insofar as paragraph 3.1.2 is referring to collateral, settlement assets, or counterparty risk issues arising in connection with membership criteria, all of these matters are covered by other Principles.

cost of producing such opinions, may reduce their effectiveness as a method for achieving legal robustness in the financial system.

It should be noted that for practicing lawyers the term "reasoned opinion" does not mean any opinion that has sound legal reasoning behind it, but an opinion in which the lawyer giving the opinion has explained the legal reasoning behind his or her conclusions. In some jurisdictions, including the United States, it is not usual for opinion givers to provide the legal reasoning that underlie their opinions unless the opinion "involves a difficult or uncertain question of professional judgment."[3] Because of this, reasoned opinions—even if they are unqualified—are often thought to be less desirable than opinions that do not explain their legal reasoning.

It might have been appropriate to insist on reasoned opinions in 1990 when the Bank for International Settlements first undertook to set out principles for payment systems,[4] because there were few statutes governing funds transfers at that time and there was a great deal of uncertainty about how legal challenges to funds-transfer system rules would fare, especially in circumstances involving bankruptcy or insolvency. Over the past 20 years, this situation has improved considerably, and it may be time for the preference for reasoned opinions to be rethought.

The Clearing House would welcome clarification of the reference to "linked FMIs," for the purposes of determining the jurisdictions with respect to which an FMI should articulate its legal basis. If this is to be understood in accordance with Principle 20 on "FMI Links," given that Principle 20 is described as not applying to SIPS, we recommend that the reference to "linked FMIs" in Principle 1 should also not apply to SIPS in order to avoid any ambiguity or inconsistency in the application of the Principles.

The Clearing House recognizes the importance of ensuring that an FMI's rules, procedures, and contracts are enforceable, however it is concerned that the requirement to ensure enforceability on the insolvency of a participant would create an unattainable standard. Enforceability in these circumstances is likely to be affected by local insolvency laws, which are not within the FMI's direct control, as well as by the actions of the participants, over which an FMI has limited control. We suggest that a more reasonable and achievable standard would be to require FMIs, for example, to "ensure that their key functions are robust and adequate to manage or withstand the insolvency of a participant."

Paragraph 3.1.11 of the Consultative Report invites FMIs to consider alternative methods for achieving legal robustness, such as participant requirements, exposure limits, collateral requirements, and prefunded default arrangements. The Clearing House supports

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[3] Committee on Legal Opinions, American Bar Assoc., *Guidelines for the Preparation of Closing Opinions,* 57 Business Lawyer 875, 879 (2002).

[4] *See, Report of the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries* (1990).

the view that, as well as seeking to establish a clear and enforceable legal basis, FMIs should investigate steps to mitigate their legal risk. However, we are concerned that the risk-management tools recommended in paragraph 3.1.11 of the Consultative Report would not be appropriate for all types of SIPS. In particular, and as explained further in relation to Principle 4 (Credit Risk) and Principle 5 (Collateral), below, we recommend that the Principles should make expressly clear that "collateral requirements" are not relevant and are not required of certain SIPS that do not take on credit risk from their participants. While we acknowledge that the risk-management tools listed in paragraph 3.1.11 are recommendations only, we are concerned that without further clarification there is a risk that they will be applied to all FMIs indiscriminately, thereby increasing their regulatory burden yet without producing corresponding benefits in terms of financial stability.

ii. Principle 2: Governance requirements should account for the different organizational structures of FMIs, particularly in relation to the appointment of "independent" board members, and should apply to the designated FMI entity only.

While the Clearing House recognizes that public interest considerations are relevant to the governance of certain types of FMI, we would welcome better clarification of the application of these requirements, particularly to privately owned SIPS. The owners and users of privately owned and operated SIPS have a strong incentive in ensuring that they are not faced with undue risks from the system and are therefore likely to be vigilant in managing these risks. We would recommend that any public-interest obligations should take account of these incentives. In this respect, we welcome the recognition in paragraphs 3.2.4 to 3.2.6 of the Explanatory Notes to Principle 2 that governance arrangements may need to differ between FMIs, *inter alia*, because of their different ownership structures. Similarly, we would recommend that the useful explanation of ownership structures in paragraphs 7.10.3 to 7.10.5 of Core Principle X is retained in the new Principles.

The Clearing House is concerned that the considerable additional detail in the Explanatory Notes to Principle 2, *inter alia*, in relation to the board of directors, reporting lines, risk management, modeling, internal controls, and audit could significantly increase the compliance obligations and costs for FMIs. We would welcome clarification of the precise scope of these requirements, as well as a clearer indication of their interaction with related Principles (for example, Principles dealing with risk management, as discussed below, and Principle 17 in relation to audit and internal controls).

The Consultative Report seems to envisage that an FMI is structured as a single legal entity with a board of directors as its governing body, whereas SIPS are configured in a variety of ways, for which this may not be the model. We consider that Principle 2 could lead to inefficiencies if FMIs generally, and SIPS in particular, are expected to justify how the various recommendations implied by the Consultative Report are allocated within the FMI.

To illustrate: our understanding is that the relevant Principles would apply to CHIPS only, as the designated FMI, and would not extend to the other activities of PaymentsCo. This reflects our understanding of Section 804 of the Dodd-Frank Wall Street Reform and Consumer Protection Act in relation to the designation of financial market utilities as systemically important.

The Clearing House is particularly concerned by the proposed requirements relating to the role and composition of the board of directors. As recognized in paragraph 7.10.13 of the Core Principles, the members of the board of directors of privately owned systems such as CHIPS are typically appointed by the participants in the system rather than the SIPS itself. Directors will be appointed only where they possess the knowledge and skills necessary to fulfill the responsibilities of a director. In this context, the requirements in paragraph 3.2.8 to control the composition of the board would be difficult for a privately owned SIPS such as CHIPS to implement and monitor in practice. While we acknowledge the recognition that the definition of "independent board members" varies and is often determined by local rules, we would welcome confirmation that this includes participant-appointed board members.

Our understanding of an "independent" board member in the context of SIPS is one who is independent of management, representing and acting in the owners' interest in achieving a valuable payments utility and the system's effectiveness in the wider payments system, including market stability. Modern payment systems are intricate businesses demanding specialized knowledge of the risks involved. In our view, the people most likely to have the requisite knowledge and capability to manage these risks would be senior officers of banks who have responsibility for payment operations. In the context of SIPS, directors who are "independent" not just of management but also of owners and users of the system are not likely to have the requisite knowledge, experience, or standing to be independent of management and, therefore, contrary to the underlying objective of seeking "independence," more likely to rely on management to exercise their functions.

We would also welcome clarity as to whether, and if so how, the requirements in relation to the board of directors would apply to other managerial arrangements, for example "business committees" as used by CHIPS. We would be pleased to provide further information in relation to the CHIPS business committee should this be helpful. To assist the application of the Principles to different types of FMIs and their different organizational structures, we would recommend that the detail in paragraphs 7.10.11 to 7.10.18 (inclusive) of the Core Principles be incorporated into the new Principles.

The Clearing House expresses its concern at the proposal that, where an FMI is wholly owned or controlled by another entity, authorities should also review the governance arrangements of that entity. While we acknowledge that the activities of the controlling entity may affect the governance of an FMI, we believe that this can be

adequately controlled through review of the FMI's governance arrangements alone. In this regard, the Clearing House would also welcome details of the procedure by which entities are to be designated as FMIs to which the Principles apply, and where the FMI is part of a larger organization, clarification that the Principles (including but not limited to those in relation to the board of directors) would only apply to the activities of the FMI in its capacity as such.

iii. Principle 18: Requirements relating to access and participation should take full account of existing, equivalent obligations under national laws.

The Clearing House acknowledges the importance of ensuring fair and open access to participants in an FMI. Nonetheless, we are concerned to ensure that the requirements proposed under Principle 18 take full account of existing laws that are designed to achieve similar, if not the same, goals (*inter alia*, competition or antitrust laws). The Clearing House believes that a failure to recognize explicitly the potential overlap between the obligations proposed under the Consultative Report and existing national legal regimes could have the undesirable effect of creating legal uncertainty and ambiguity in the application of the Principles, as well as increasing the compliance burden on FMIs, without achieving a corresponding gain in efficiency and effectiveness. In order to avoid this legal uncertainty from arising, we recommend that the Principles should clarify that the requirements proposed under Principle 18 only apply to the extent an FMI is not already subject to equivalent obligations under national laws.

iv. Principle 19: The terms "tiered participation arrangements," "indirect participants and "interdependent FMIs" should be more precisely defined. The scope of an FMI's obligations in relation to indirect and interdependent entities should be proportionate to the risks they pose.

The Clearing House supports the intention to manage risks posed to FMIs, including SIPS, by certain "indirect" and "interdependent" participants and entities, but would also welcome clarification of both the intended scope of the proposed obligations as well as their interaction with an FMI's obligations under Principle 3. In particular, we would welcome a clearer distinction to be drawn between "tiered participation arrangements" and other arrangements involving chains of participants.

The Clearing House would also welcome greater clarity as to the meaning of "indirect participants" and "interdependent FMIs." We note the definition under paragraph 3.19.2 of the Explanatory Notes to Principle 19 of "indirect participants" as "entities that are not bound by the rules of the FMI, but whose transactions are recorded, cleared or settled by or through the FMI." While our understanding is that this definition would exclude customers of "direct participants" in an FMI, we would recommend that this be stated explicitly, particularly in light of various references to customers in paragraphs 3.19.1, 3.19.3, and 3.19.4, and that guidance be given on the distinction between "customers" and "indirect

participants." Furthermore, it should be clarified that "indirect participants that are larger than the direct participants," under Key Consideration 2, are only a source of risk (and therefore risk-management obligations) for FMIs where they also have a significant daily turnover in the system (specifically, where this is significant relative to the direct participant's ability to absorb corresponding risks).

Some of the language in the Explanatory Notes to Principle 19 suggests that the Consultative Report intends to include simple bank-customer relationships, such as correspondent banking, in the category of "tiered participation arrangements." We believe that no bank-customer relationship should be regarded as a tiered-participation arrangement simply because a bank may use an FMI to execute customer payment orders or because a bank receives a payment order for a customer through an FMI.

A bank (other than a beneficiary's bank) that receives a funds-transfer payment order from a customer will execute that payment order by sending a corresponding payment order to another bank, either the beneficiary's bank or a subsequent intermediary bank. In doing this, the bank will have a number of options, and the choice of a particular FMI will be based on a number of factors that may change from time to time, even minute to minute. In any case, the risk to the bank arises not from its participation in an FMI, but from its correspondent relationship, and banks have evolved techniques for dealing with this risk, including balance checks and explicit evaluations of their customers' creditworthiness.

On the receipt side, receiving banks or their customers may expect to receive payments from other banks through an FMI or otherwise, and failure to receive a payment may cause problems for the customers. Nevertheless, payments fail every day for reasons that are largely unrelated to the FMI (e.g., insufficient balances or credit lines, violations of economic-sanctions laws, attachment or garnishment,) and it follows therefore that an FMI should not intervene in these relationships.

We agree that banks that send or receive payments or other financial transactions for customers through FMIs should understand the risks that they incur through their participation. However, this is already adequately dealt with under Principle 3, and should not require customer-bank relationships to be brought under the tiered-participation umbrella.

To the extent that a relevant "tiered participation arrangement" is identified, the Principles should clarify that an FMI's obligations to manage the risks they give rise to are limited to the extent proportionate to such risks. This will avoid an unreasonable and unnecessary compliance cost being imposed on FMIs. In particular, we consider the proposed requirement under Key Consideration 3 of Principle 19, for an FMI to identify potential issues in terms of "legal structure, finality or the stable operation of the system,"

to be unreasonably broad and would recommend that it is limited "to the extent practicable," in accordance with Key Consideration 1 of Principle 19.

Furthermore, we would welcome greater clarity on the interaction between Principle 19 and Principle 3, particularly in relation to the management of risks posed to an FMI by "other entities." The differences between "tiered participation arrangements" and "FMI Links," which are dealt with under Principle 20, should also be clarified to avoid any ambiguity in interpretation, particularly as Principle 20 does not apply to SIPS.

v. Principle 21: Some obligations in relation to efficiency and effectiveness may not be necessary for privately owned FMIs operating in competitive markets.

The Clearing House fully supports the need for FMIs to be efficient and effective; however, we are concerned that some of the obligations proposed under Principle 21 may not be necessary for privately owned and operated systems. For such systems, in a marketplace where there is active competition between providers of clearing and settlement services, we believe that efficiency and effectiveness are and should continue to be determined by market forces, with minimal regulatory intervention. In particular, we believe that specific recommendations in relation to minimum service-level targets, business priorities, and review of cost and pricing structure (*inter alia*) may exceed the degree of regulation necessary to achieve efficiency and effectiveness for an FMI operating in an economically developed market.

We would welcome clarification under the Principles of the specific types of FMIs, including types of SIPS, to which these recommendations are intended to apply.

vi. Principle 22: The requirement to use "internationally accepted" communications procedures and standards should permit a sufficiently broad range of standards and procedures to continue to be used and should not mandate conformity with specific standards, such as SWIFT or ISO 20022.

The Clearing House is concerned that the proposal for FMIs to use or accommodate the use of "internationally accepted" communication procedures and standards may create an undue compliance burden for FMIs. We acknowledge that the use of consistent standards and procedures will aid interoperability and communication between FMIs and their participants, customers, and other users, thus facilitating efficiency across systems. However, we are concerned to ensure that the reference to "internationally accepted" recognizes a sufficiently broad range of comparable and interchangeable standards and procedures and will not mandate conformity with a specific standard or procedure, which may impose an unnecessary and costly compliance burden on FMIs without producing corresponding gains in efficiency.

We would welcome clarification of the meaning of "internationally accepted" procedures and standards. We do not interpret the Consultative Report as endorsing the

use of SWIFT or ISO 20022 over other forms of communications procedures and standards, but consider that there is a risk, without further clarification, that regulators would consider that such a conclusion is implied. In our view, market users should decide on the appropriate form of communications methodology and whether to conform to international standards (and if so which standards). Some FMIs may use proprietary communications networks or protocols, and we do not see the rationale for that to be abandoned where it is preferred by the FMI's users.

We refer in particular to the reference to the International Organization for Standardization ("**ISO**") at paragraph 3.22.1 of the Explanatory Notes to Principle 22. While we acknowledge that this does not mandate the use of ISO standards, we recommend that this reference should be qualified in order to avoid the risk that it is interpreted as creating mandatory obligations. For example, a suitable alternative could be to state that FMIs "may wish to consider and potentially adopt the relevant standards promulgated by the International Organization for Standardization, among others."

In this respect, we also reiterate our general recommendation, as discussed in section II above, that it should be made explicitly clear that only the Principles create regulatory imperatives, with the Key Considerations and Explanatory Notes providing helpful guidance. This will ensure that regulators are given sufficient flexibility in the application and implementation of the obligations proposed under the Consultative Report. In addition, and as noted in relation to Principle 21 above, we do not believe that the specific regulation of communication procedures and standards is necessary to achieve efficiency in privately owned systems operating in competitive markets. We recommend that the application of the Principles to different types of FMIs, including different types of SIPS, should be clarified.

vii. Principle 23: The requirement for public disclosure of an FMI's rules and procedures should be limited to the extent necessary to achieve effective risk management and tailored to the individual circumstances of each type of FMI.

While we acknowledge the importance of informing participants in an FMI of the risks that they face, we are concerned to ensure that the public disclosure of an FMI's rules and procedures does not exceed the level necessary to achieve this objective. In particular, we are concerned that the proposal for public disclosure of "all relevant rules and key procedures" may result in an onerous and disproportionate disclosure burden for FMIs. We do not believe that the public disclosure of a SIPS's fees and related policies is necessary to achieve better risk management by participants and would recommend that Key Consideration 4 and corresponding paragraph 3.23.5 of the Consultative Report be amended accordingly.

The Clearing House is also concerned that an excessively broad disclosure obligation could have the undesired consequence of putting an FMI's systems and operations at risk of

interception or misuse: for example, disclosure of security protocols would undermine the defenses of the FMI for protection against fraud and money laundering. In this respect, we favor the approach taken under Core Principle II, which requires public disclosure of "key rules relating to financial risks" i.e. only those rules that are likely to be most relevant to participants in a particular FMI. In the context of SIPS, this would mean disclosing only those rules and procedures that enable participants to assess and manage the risks associated with settling payment transactions through the SIPS and that allow parties to a funds transfer sent through the system to understand the rights and obligations with respect to the transaction.

The Clearing House also reiterates its general recommendation, discussed in section II above, that the application of each Principle to each type of FMI should be clearly stated (including the Key Considerations and Explanatory Notes). For example, the use of terminology such as "procedures" may be better suited to CCPs that, *inter alia*, operate procedures for position management. By contrast, SIPS do not typically use "procedures" in the same sense as other FMIs and there is a danger that without more definitional precision, the Principles may mandate the disclosure of rules, such as the technical operating standards of a SIPS, that were not intended and ought not reasonably to be disclosed. These concerns would also be addressed by a more precise definition of the scope of the relevant "public" to which an FMI must disclose relevant rules and procedures. We would welcome further definitional clarity in these respects.

B. Risk Management Principles

Though The Clearing House generally supports measures to improve the management of risks faced by FMIs, we recommend that Principles that are not relevant to SIPS, or certain types of SIPS, should explicitly not be applied to them. We believe that this will avoid ambiguity in the interpretation and application of the Principles by national regulators, thereby ensuring that the obligations imposed on FMIs correspond to their individual risk profiles.

i. Principle 3: Proposed obligations to manage risks posed to an FMI by other entities may impose an excessive and potentially unattainable standard on SIPS. The scope of requirements to provide "incentives" and "capacity" should be clarified.

The Clearing House fully supports the need for an FMI to have a sound risk management framework; however, we would welcome greater clarification of the precise scope of the proposed obligations. In particular, The Clearing House would welcome clarification of the requirement to provide "incentives" and "capacity" to an FMI's participants and their customers to manage and contain their risks. Our understanding, based on the language of paragraph 3.3.5, is that this would create an obligation for FMIs to educate participants of the risks that they face, for instance by carrying out periodic

simulations of participant failures, thereby enabling them to understand and thus be able to manage their own risks. On this basis, we do not consider the imposition of penalties (for example) to be a method by which SIPS would be required to provide "incentives." We would recommend that this be fully clarified, particularly under paragraph 3.3.5 of Principle 3. In this respect, we favor the language of Core Principle III, in particular paragraph 7.3.14 in relation to "incentives," and would recommend that this be retained under the new Principles.

The Clearing House is concerned that the proposed extension of an FMI's obligations from managing risks posed only by participants (under Core Principle III) to also managing the risks that it bears from other entities, for example "linked FMIs," or as a result of interdependencies, would because of its open-ended nature impose an excessive and potentially unattainable compliance burden on FMIs. Moreover, given that Principle 20 on "FMI Links" does not apply to SIPS, we recommend that any requirements relating to linked entities also not be applied to SIPS in order to avoid any ambiguity and inconsistency in the application of the Principles.

ii. Principles 4, 5, 7: Obligations relating to credit risk, liquidity risk, and collateral should only apply to FMIs that assume such risks.

The Clearing House is concerned that obligations relating to credit and liquidity risk (including but not limited to collateral requirements) are currently stated to apply to certain types of FMIs that do not assume such risks. In particular, SIPS that assume little or no credit and liquidity risk from their participants should not be required to take credit or liquidity risk management measures. In these systems, credit and liquidity risks arise between participants in the system only, rather than between the FMI and its participants, and are appropriately managed by the participants themselves.

We would recommend that the application of these Principles to each type of FMI be stated explicitly. We would also welcome clarification of the interaction between these Principles and Principle 3 in relation to the framework for the comprehensive management of risks.

iii. Principle 15: Obligations to achieve an "orderly wind-down" or "reorganisation" of an FMI should be commensurate with its risk profile. Obligations relating to asset and capital maintenance should reflect the specific organizational structure of an FMI.

The Clearing House is concerned that, without further explanation, references under Principle 15 to achieving an "orderly wind-down" or "reorganisation" of an FMI's operations and services could lead to a broad range of potentially onerous obligations being imposed on FMIs. We understand that one primary objective of Principle 15 is to ensure that an entity operating an FMI has adequate resources to ensure continuity of service in the event

of a cessation of its activities as a provider of an FMI. However, Principle 15 goes further than this, and potentially very substantially further. In particular, we refer to recent international proposals requiring systemically important financial institutions to prepare "living wills," as imprints for their recovery following a financial crisis. As these would impose a costly and time-consuming compliance burden on FMIs, we would welcome clarification of the specific obligations envisaged by the references to "orderly wind-down" and "reorganisation," to ensure that they are commensurate with the risk profile of each type of FMI.

As noted in relation to Principles 4 and 5, above, we are concerned that requirements to maintain capital may be applied to FMIs to which they are not relevant, in particular, FMIs that do not assume counterparty risk. Furthermore, it is important to distinguish equity capital maintenance from asset maintenance requirements. In the context of SIPS, the revenue stream generated by the payment of clearing fees by participants, combined with the accumulation of capital reserves, should provide a sufficient level of risk mitigation. We recommend that references to an FMI's "capital plan" should be amended accordingly so that they adequately reflect the different organizational structures of FMIs.

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We would be happy to discuss these comments further with you. We appreciate the opportunity to provide our input and look forward to future opportunities to do so. If we can help to facilitate further discussions with you on these matters or assist you in any other way, please do not hesitate to contact me at (001) (212) 612-9234 (e-mail: joe.alexander@theclearinghouse.org).

Respectfully submitted,

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Senior Vice President, Deputy General Counsel, and Secretary

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Mr. John Walsh
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The Honorable Mary Shapiro
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