

## **Comments by the WMBA on the CPSS-IOSCO consultative report “Principles for financial market infrastructures”**

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## WMBA and LEBA response to IOSCO on Derivatives Infrastructure Standardisation

1. We limit this response to the few most important issues for the WMBA/LEBA.
2. We support the particular role of CPSS IOSCO as a global standard setter with the objective of mitigating the risk of diverse nationalistic approaches to derivatives regulation and supervision which may overlap, prevent competition or raise systemic risks. WMBA/LEBA has co-signed a recent Trade Association letter to key regulators (attached) outlining our concerns about the extra-territorial scope of recent regulations passed in response to the G20 concerns.
3. With the mandating of standardised derivatives for clearing and the increasingly differential capital treatment of cleared versus uncleared derivatives, it becomes of the most utmost importance that “qualifying CCPs for Basle3 exposure rules” are only included if they can be demonstrated to comply with CPSS-IOSCO global standards.
4. WMBA/LEBA consider the cost/benefit balance to mitigate systemic risks to be substantially greater from the use of Trade Repositories than from the transfer of the aggregate open risk into Clearing. Market participants frequently request trade venues to also act as trade reporting agents. This role therefore frequently falls to our member firms. Therefore we would advocate the introduction of standards that ensure the confidentiality of client risk; common and open data reporting formats/standards/technologies; globally standardised product and trade identifiers; and efficient cooperation between Trade Repositories.
5. **Principle 4: credit risk** - The WMBA is of the view that an FMI should be required to apply stable and robust risk management policies, but that it is the role of the supervisors to be dynamic and to make timely stressed scenario tests by carrying out close, continuous and efficient oversight. We emphasise that the resilience and credit quality of an FMI is only as good as the sum of the credit quality of its constituent Clearing Members. As such, until an FMI is efficiently and robustly able to quantify this summation and co-dependence with other FMIs, then any benefits of moving aggregate risk into these structures will not be gained.
6. **Principle 7: liquidity risk** - we consider that, in order to be efficient, regulation determining an FMI's additional financial resources needs to take into account the diversity and correlation of business models within the FMI and the degree to which they may be vertically aligned and therefore co-dependant, or operate as stand along models.
7. **Principle 14: segregation and portability** - Whilst we consider portability to be fundamental, in the interests of both choice and cost given the forthcoming clearing mandates, we believe that segregation should be offered, but should not be a mandated requirement.
8. **Principle 15: general business risk** - failure and resolution need to be firmly within the scope of the principles with the commensurate portability of segregated positions finding due recourse, rather than such a principle embracing a “*too big to fail*” mantra with the associated costs.
9. **Principles 18 to 20: access and interoperability** - an FMI must be legislated to permit stakeholders and participants *fair, open and non-discriminatory access to its services*. With the passage of mandated clearing and incentives within the Basle3 framework, *access to an FMI becomes, if not in practice, in principle, should be considered a utility-like service as opposed to a commercial offering*.

Mandatory clearing will increase the use of CCPs and the links between CCPs will create more aligned operational and financial risks. Principles should

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therefore concentrate on outcomes rather than processes so that a more diverse set of methodologies is established to lower systemic risks.

Lack of interoperability between CCPs increases concentration of risk set inside a single operating infrastructure. Assuming that mandatory clearing will increase the number of links between FMIs in general and CCPs in particular, the WMBA recommends that, a very close scrutiny, preferably via a Public Consultation, be made before deeming a particular class of derivative as Clearing Eligible and thus submitting it for consideration into mandatory clearing.

One of the most substantial and prescient benefits from increased linkages between FMIs will be found in the continual and thorough peer review processes that such operations demand upon each member of the group.

The WMBA stresses however, that FMIs should not be competing on the basis of risk management standards. Their risk management arrangements should be subject to regulatory approval, constant regulatory review and be published to participants and stakeholders.

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## WMBA and LEBA response to IOSCO on Derivatives Infrastructure Standardisation

*The WMBA welcomes the opportunity to comment on the CPSS-IOSCO consultative report on "Principles for financial market infrastructures". The WMBA would like to underscore that its comments are written from the perspective of stakeholders and participants (both direct and indirect) in financial market infrastructures (FMIs). In this respect, we note that whilst we understand the role of Interdealer Brokers (IDBs) to be a key part of the financial market infrastructure, as per the definitions laid out by CPSS-IOSCO, our member firms do not themselves constitute an FMI.*

*Operating as the hub of the global financial market infrastructure, IDBs are MiFID compliant and highly regulated intermediaries by virtue of their regulatory authorisation and from being subject to supervision under CAD as Limited Activity firms. Our members are neutral, independent, and multi-lateral and provide, fair and open access to their trading venues for all suitably authorised and regulated market participants. IDBs do not take positions in the markets they operate in and their collective service as the gateway to the global financial marketplace creates high quality price discovery, pre-trade transparency and liquidity. All transactions, whether executed via voice, hybrid or fully electronic means, are immediately captured at the point of trade, are subject to straight-through-processing, and post-trade are made available for transparent and timely transaction reporting to the relevant regulators.*

*As IDBs, the WMBA members' principal client base is made up of global banks and primary dealers. The replies below to the questions in the paper should be seen in the context of WMBA members acting exclusively as intermediaries, and not as own account traders. (Please see [www.wmba.org.uk](http://www.wmba.org.uk) and [www.leba.org.uk](http://www.leba.org.uk) for information about the associations, its members and products.) For this reason some of the questions in the Consultation Paper are not entirely relevant to WMBA members' activities even though they are to most of their clients. Further, some answers take into account industry views and experience.*

*The IDB community facilitates fast and fully automated affirmation/confirmation of all OTC and derivatives trades. This affirmation and confirmation of all trades in all markets needs to be accelerated as close as possible to the trade date. The OTC market has already invested significantly in developing its infrastructure in pre-trade, electronic matching, affirmation and confirmation segments. This infrastructure already contributes hugely to reducing risk and will be continuously enhanced through competition for the benefit of all. The infrastructure developments pioneered by the IDB community will foster quicker settlement cycles in all securities and derivative markets.*

*The IDBs are at the forefront of the wider adoption of electronic trading. However, we reiterate that voice and hybrid initiated matching has nearly identical price transparency to fully electronic matching. Specifically, voice execution similarly enables simple and fast trade capture, including equivalent affirmation, confirmation and supervision of trading activity. It is imperative for the OTF framework to foster the wholesale gathering and building of liquidity through flexible means of intermediation and execution inclusive of voice, hybrid and electronic.*

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### General remarks

Both as financial market participants and stakeholders, members of the **WMBA fully 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. Better designed, operated and supervised FMIs will prevent financial shocks from being amplified around the system and enable competition to foster innovation and therefore enhance the efficiency and efficacy of the provision of these services to end users and society at large.

Given the systemic nature of many FMIs, and the central role they play in financial markets, the WMBA believes that the Principles should strike the correct balance between preserving financial markets' stability, ensuring fair competition amongst themselves and those that provide services to the FMIs. Allowing fair and non-discriminatory access to FMIs for all stakeholders, participants and their clients in turn, are essential to maximise utility and ensure that systemic risks are minimised. The lack of an adequate balance between safety and efficiency would simply lead to a reallocation of risk and the unintended consequence of effecting increased risks in the financial system.

Whilst the WMBA supports the legislative policy actions that are underway around the globe, we note that the industry as a whole and our member firms in particular have invested significant time and effort in the continuous development of technology solutions to ensure a robust and resilient post trade environment which has been on-going since long before the beginning of the financial crisis. Many of these 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 as one of the reasons that the financial markets continued to function efficiently and effectively during the peak period of the crisis in September of 2008.

In this respect, the WMBA believes that it is essential that the Principles for FMIs are taken globally as the fundamental basis for the various regional or national legislations that are currently being developed. This is especially important given the increasing international and cross border aspects of FMIs. Indeed we note that in the normal course of business for an IDB, any typical deal arranged by our members may match wholesale participants from opposing sides of the world negotiating a derivative contract trading in a third location, based on an underlying in a fourth which settles on an FMI in a fifth regime and may need to be reported to a trade repository (TR) in one or more of the aforementioned jurisdictions.

The WMBA is of the view that neither global financial stability nor efficiency could be enhanced by the complexity resulting from the possible co-existence of differing regulatory frameworks applicable to FMIs. To this end, not only lowered standards employed to attract business are undesirable but we also stress that the moves towards "gold plating" by individual regimes are equally counterproductive in such an interlinked world. To this end, we note 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.

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The WMBA considers that all the relevant authorities are expected to regulate and supervise FMIs consistently with the Principles. In this regard, we note that international coordination between the home regulator and the host regulator is of utmost importance to avoid gaps in knowledge, regulatory arbitrage or potential duplications.

With the mandating of standardised derivatives for clearing and the increasingly differential capital treatment of cleared versus uncleared derivatives, it becomes of the most utmost importance that “qualifying CCPs for Basle3 exposure rules” are only included if they can be demonstrated to comply with CPSS-IOSCO global standards. Given the variety of participants and risk mitigation methodologies with the OTC markets, we uphold the need for flexibility to maintain and evolve optimum market structures not only in times of crisis, but in the every day execution of risk transfer. Therefore the mandating of particular post trade infrastructures is inefficient and the law would be better replaced by the use of Basle3 capital rules which are both proportionate and global.

WMBA/LEBA consider the cost/benefit balance to mitigate systemic risks to be substantially greater from the use of Trade Repositories than from the transfer of the aggregate open risk into Clearing. Market participants frequently request trade venues to also act as trade reporting agents. This role therefore frequently falls to our member firms. Therefore we would advocate the introduction of standards that ensure the confidentiality of client risk; common and open data reporting formats/standards/technologies; globally standardised product and trade identifiers; and efficient cooperation between Trade Repositories.

We note the various recent reports that have highlighted the reinforcement for higher demands for collateral that will be required by both FMIs and from the CRD/Basel III, the impact of which may lead to a scarcity in such highly liquid forms of collateral. Such a crowding out of available working capital may leave only the largest institutions with sufficient access to capital markets and reduce that which could be available for lending to the real economy. Consequently, the WMBA would encourage 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. Repeating our plea for proportionality & balance, tying up liquidity in certain FMIs such as CCPs may initially appear to be positive for financial stability or political passage but it may have adverse consequences for liquidity, hedging activities or the efficient allocation of capital resources.

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### **Detailed Remarks on the Consultative Report**

*Where not otherwise stated, the WMBA concurs with the positions stated in the IOSCO paper.*

#### **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 WMBA concurs with CPSS-IOSCO that **a legal framework that protects the participants and stakeholders of an FMI from the insolvency of a**

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**clearing member is of the essence.** Whilst we agree that it is essential to guarantee the ownership rights for any investor over the financial instrument credited to its accounts across global legal and national jurisdictions, we especially want the straightforward application of laws delineating the utility type behaviour of FMIs with respect to the fair access and non-discriminatory treatment of all financial market participants and the subjugation of those laws to the relevant competition parameters.

We would also advocate a **stringent regulatory approach regarding possible ancillary services** offered by FMIs, since not only would these be likely to involve additional risks they would also change the approach to pricing structures, competition and the use of data. Here we would note the bundling of execution, reporting, clearing and trade repository functions within the same commercial entity of holding company.

**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 WMBA 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 stakeholders*”. As IDBs who shall be mandated to pass their trade information on to FMIs we note that by broadening out these governance criteria beyond *participants* and onto *stakeholders*, the text recognises that these principals affect a much larger constituency of interests than, say, only clearing members of a CCP. As such we very much welcome the principle that such stakeholders as IDBs, who may well be the entire source for a set of derivatives given up to a CCP and reported to a TR, would have the opportunity to place a representative into the senior governance structure of the relevant FMI. In addition, it is imperative that a CCP have a clearly understood and published escalation process for dealing with dispute resolution.

Importantly, the WMBA would like to underscore its support to CPSS-IOSCO as they note that *FMI providing services that present a distinct risk profile from its primary function*, should ensure that adequate legal and/or governance arrangement are in place to prevent possible conflict of interests and risk propagation.

One role of the WMBA collectively, as well as its members on an individual basis, is to provide independent and timely pricing information to CCPs for the calculation of variation margin both intraday and at the end of day. Therefore, we concur with the committee that the process of model and methodology validation should involve supervisory authorities since most other sources of such prices would necessarily infer the use of estimation. Therefore, supervisors should have the power to assess the adequacy of the marks and the models to the pricing information employed by an FMI.

With regards to systemically important payment systems (SIPs), we would advocate a clear distinction between the governance of SIPs and other FMIs. The governance of SIPs is generally handled by the banking industry (CLS for example) with direct recourse to the relevant central bank(s) [Fed and BoE in the case of CLS].

**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 WMBA agrees that FMIs should take an integrated and comprehensive view of its risks, including the risks it bears from and poses to its participants and their customers. Since our members focus closely upon operational risks we would encourage the governance structures of FMIs to put into place an operational structure to investigate and seek to mitigate these types of derived risks from their business models.

Given the prime importance of managing its own risk set, the WMBA 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.

We consider the framework of a "Cover One" versus a "Cover Two" minimum credit requirement to be far too prescriptive. In fact a variety of risk factors applying to specific Clearing Members should be used to develop a minimum capital ratio that the CCP should hold against the properties of the aggregate risk inside the infrastructure.

**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.*

Given our statements above concerning the interaction of Basle-III with various national clearing regulations, we shall witness an increasing scarcity of available collateral. The WMBA considers that an FMI should be flexible and proportionate in its requirements for acceptable collateral, in accordance with changes in underlying risks.

The WMBA notes that beyond the traditional banking system, financial market participants mandated into clearing may not have the available liquid assets (i.e. Pension Funds or Insurance Companies) and therefore, with a suitable haircut, should be able to rehypothecate those assets usually held by the entity as suitable margin.

We also note that almost any market stress should likely bring the FMI into a conflicting situation with its member firms or with the preservation of wider market stability. We note the pivotal instance of LCH calling more margins for Irish sovereign risk as a recent case in point. Therefore, the WMBA would agree with 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.*

We would agree with the reference made to the *use of cross-border collateral to provide an efficient liquidity bridge across markets*, but note that the FMI should consider Foreign Exchange-related risks which involve not only rates, but liquidity and timing of payments issues in stressed events.

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**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 WMBA broadly supports all seven sections of this Principle.

**Credit and liquidity risk management****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 WMBA is of the view that that an FMI should be required to apply stable and robust risk management policies but that it is the role of the supervisors to be dynamic and to make timely stressed scenario tests by carrying out close, continuous and efficient oversight.

The Associations agree with the definition of credit risk and liquidity risk provided by CPSS-IOSCO.

Furthermore, the WMBA 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 and correlation of business models within the FMI and the degree to which they may be vertically aligned and therefore co-dependant, or operate as stand along models.

With regard to liquidity risk management, the WMBA believes that the "cover two scenario" should be the minimum requirements for payment systems since the same set of firms form both the core clearing members of most of the CCPs whilst also accounting for the majority of OTC volumes. The failure of two major firms in the 2008 crisis would point to this second scenario as being both the most sensible and prudent.

**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 WMBA firmly believes that legal, certainly around final settlement, is the major component of systemic stability and should therefore be guaranteed. Whilst we would welcome the clarity embodied with this set of principles, we would also seek further guidance as to when a trade may be legally considered to be complete or "done".*

We understand the concept of "Finality" to come 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. This Principle is already applied in the EU through the *Settlement Finality Directive* but would benefit from global application.

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Moreover, while the WMBA notes that intraday or real time settlement is “preferable” to end of value date settlement in order to reduce settlement risk, as arrangers of the vast bulk of OTC trades we would advise CPSS-IOSCO to reconsider adding a target of settling intraday or in real time since we understand that frequently details to trades are only finalized at the end the trading day, and therefore a suitable and proportionate interval will aid both the netting and aggregation of trades to make settlement and clearing more efficient and resilient.

**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 WMBA believes that **settlement in central bank money is preferable where available** but suitable flexibility should remain possible provided that exposures are properly managed in real time.

**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.*

WMBA agrees with the policies an FMI needs to clearly state in advance of its processing and treatment of physical deliveries.

We would further note that the transformation of physical delivery to a financially settled index at an appropriate and most liquid point of the contract shortly in front of delivery would normally serve to greatly reduce the set of risks associated with such contracts. To this end, LEBA publishes a set of settlement indices across the European energy and emissions product set which serve to promote liquidity and reduce settlement risks in the associated commodity derivatives markets.

**Central securities depositories and exchange-of-value settlement systems****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.*

We understand 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. Such core functions are registration, central safekeeping and central settlement. Further activities, such as the administration of corporate actions, should have a utile connection with the core services and must mitigate, rather than seek to create, additional risks over and above the standard operational risk associated with core functionality. The WMBA therefore shares the view of CPSS-IOSCO that, a CSD

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*may need to separate legally the other high-risk activities it may perform along its core functions.*

**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.

WMBA strongly advocates the extended use of Exchange-of-value settlement systems which utilise the DvP, DvD, and PvP methodologies. We note the great success of CLS in the foreign exchange markets largely matched via our members, and the importance of settlement relative to clearing for many markets.

With increasing flow volumes and decreasing ticket size, we also note the need for the gross and net settlement systems to be joined by an aggregated settlement system to reduce pressure upon system bottlenecks.

**Default management****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 WMBA agrees that continued smooth and robust operation of an FMI in distressed situations is of the utmost importance and supports FMI access to additional resources, such as the default fund or the FMI's own funds and equity capital. The scenarios, order and conditions for using such "own resources" need to be clearly defined a-priori.

In order to maintain access to such additional resources via its guarantees, an FMI needs to consistently supervise the financial condition of its participants; therefore it should promptly inform the competent authority when it considers such a participant may default. Early warning should permit an efficient and mutual dialogue between FMI and supervisors, mitigating 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 WMBA agrees that the segregation of indirect participants' positions and collateral gives confidence and enables the safe and effective holding and transfer of client assets. Effective segregation options can also reassure and may reduce the impact of a clearing member's insolvency on its customers. Indeed, the Basel Committee have endorsed 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.

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However, in the interests of both choice and cost given the forthcoming clearing mandates, we believe that *segregation should be offered but should not be a mandated requirement*. The WMBA is agnostic as to the presented models for segregation of assets and margins.

**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.*

Given that the cost of any additional capital buffer must ultimately be borne by the users of FMIs, and therefore detract from the efficacy of managing risks, we note that this principle needs to be borne with flexibility and in strict proportion to the perceived benefits. That is, failure and resolution need to be firmly within the scope of the principles with the commensurate portability of segregated positions finding due recourse, rather than such a principle embracing a "too big to fail" mantra with the associated costs. We would, therefore, recommend that the relevant supervisors should carry out intensive and efficient oversight functions, in order to facilitate the efficient winding up of FMIs when and where appropriate.

The WMBA also notes that this Principle requires an FMI to "hold sufficient liquid net assets funded by equity to cover general business losses so that it can continue providing services as a going concern". However, this requirement does not seem appropriate in situations where the infrastructure is owned by the users as opposed to third-parties. In such situations, guarantees or covenants from the users may be more appropriate to maintain efficiency.

***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 WMBA 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.

However, the WMBA emphasises the limited applicability of this new Principle in the context of the growing demand for collateral. In the case of rehypothecating more complex investments from a market participant (such as a pension fund), or owning the underlying asset to a derivative (such as carbon permits), the FMI needs sufficient flexibility to direct its investments under a broader set of prudential mandates.

Allied to the above, assets posted to an FMI inside and across various global jurisdictions need to have equivalent legal rights and protections.

**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 fulfillment of the FMI's obligations, including in the event of a wide-scale disruption.*

The WMBA strongly support this principle that an FMI should establish a *robust operational risk-management framework* to enable timely and complete identification, monitoring, management and prevention of operational risk. All FMI participants need to ensure due transparency in their risk management in order to minimise operational risk by implementing policies for appropriate systems, procedures and controls. Such policies should define *a priori* a **clear and precise classification of the operational risks** the FMI may encounter in the conduct of its activities.

The WMBA appreciates the importance given to business continuity planning which we regard as extremely important and necessary so as to ensure that an FMI is able to carry on its functions in all circumstances. Whilst direct participants may be quickly informed of operational failures, we would extend this principle to all stakeholders whose businesses are co-dependant with the FMI (such as IDBs).

We also concur that **regular testing** is of such crucial importance that it is suggested that a maximum period between major tests should be stipulated and made public.

**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 WMBA agrees with CPSS-IOSCO that an *FMI must be legislated to permit stakeholders and participants fair, open and non-discriminatory access to its services*. With the passage of mandated clearing and incentives within the Basle3 framework, access to an FMI becomes a utility like service as opposed to a commercial offering. Any CCP must accept matched trades from third party venues on the same terms with respect not only to costs, but also integrity, speed, technology and security, as it may from vertically integrated trading venues within its own ownership structure.

Participation requirements for an FMI should be *transparent and equivalent*. Whilst access to an FMI cannot be indiscriminate, the setting of criteria and their ongoing policing needs to be the duty of the supervisory authorities rather than of the FMI itself (*who may likely be commercially interested*). Whilst legislation needs to be shared between the financial and the competition authorities, fair and open access must be closely supervised and any remedies applied in a timely manner, via a publicly disclosed dispute resolution process, given the fast evolving nature of financial market places.

**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.*

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The WMBA agrees in principle with CPSS-IOSCO that an FMI should try to identify, understand and manage the risks arising from tiered participation arrangements. The Principle should, however, not be binding since we would be *concerned as to the extent an FMI can or should try to interfere in a commercial relationship between one of its stakeholders and that firm's own customers*, relationship of which it may well have no direct visibility.

**Principle 20: FMI links**

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

The WMBA understands that the links between FMIs will continue to increase in strength, importance, numbers and complexity. We understand that such links are as easily provided to derivatives as they are to cash securities provided that there are clear, strict, sound and robust risk management rules for the establishment of such arrangements.

The WMBA shares the view of CPSS-IOSCO that mandatory clearing will increase the use of CCPs and that links between CCPs will create more aligned operational and financial risks. To this end, we endorse principles for FMIs that concentrate on outcome rather than processes, such that a more diverse population of methodologies is encouraged to lower systemic risks.

Interoperability arrangements between CCPs may increase the efficiency of collateral, competition on the quality of service and ease portability. We further understand that for derivative clearing interoperability arrangements to be effective, CCP resolution arrangements need to be explicit and compliant. Currently there is no legislation in any jurisdiction setting out a legal framework for the resolution of a CCP. We understand that the EU Commission intends to draft proposals for such following work on bank resolution. Ahead of such regional initiatives, we think it is important that CPSS-IOSCO issue a set of principles and standards to guide the methodology and outcomes for CCP resolution. To that end, the absence of these within the consultation document is the most glaring omission, and we would ask the committee to resolve such as soon as possible.

One of the most visible consequences in the event that interoperability between CCPs does not materialise is the concentration of risk inside a single legal infrastructure. If mandatory clearing will increase the number of links between FMIs in general and CCPs in particular, as suggested in the cover note to the consultative report, the WMBA would then recommend that, a very close scrutiny be made before submitting a class of derivative into mandatory clearing. One of the most substantial and prescient benefits from increased linkages between FMIs will be found in the continual and thorough peer review processes that such operations demand upon each member of the group.

The WMBA stresses, however, 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 and stakeholders. Cross-border FMI links should be subject to *equivalent supervision by competent authorities via a system of non equivalent* passporting recognition close to that developed by the asset management directive.

**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 WMBA concur and note that without this principle, FMIs may indeed be competent, safe and reassuringly expensive but would not serve purpose to enable the economy to provide growth and stability.

**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 WMBA generally supports this Principle but would note the current enquiries by competition authorities into the pricing structures of communication protocols which have become widely accepted standards. As far as communication protocols and networks are concerned, we believe it is essential that authorities can check to ensure that there is a level playing field in terms of cost and functionality, 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 WMBA backs the principle that an FMI should provide sufficient information to its participants and stakeholders to enable them to identify clearly and understand fully the risks and responsibilities of participating. Such principle should, however, be careful not to impinge on either the security of the system, nor its commercial confidentialities in order to preserve competition and end user efficiency.

**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 WMBA fully supports the provision of timely and accurate data by FMIs such as TRs and CCPs to relevant supervisory authorities for both macro and micro prudential analysis, **disclosure of commercially sensitive data to competitors or to the public needs to be avoided to preserve market utility.**

Whilst we understand the claims of both the public and of the academic community upon the data retained within **TRs, it is imperative that this access must be assessed carefully** in the context of the impact this may have on-going confidence as pertains to market liquidity or fiscal obligations. However, aggregated breakdowns and anonymous data may be easily provided at an appropriate frequency to ensure confidence. We note that the consultation utilises the phrase "*as available and appropriate to the public*" which should be referenced when seeking for greater transparency to the broader public.

WMBA and LEBA response to IOSCO on Derivatives Infrastructure Standardisation

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**VI. Annex to reference materials:**

- a. Trade Association Letter on concerns about Extra-Territoriality  
[http://www.wmba.org.uk/execution\\_policy/concerns-about-Extra-Territoriality](http://www.wmba.org.uk/execution_policy/concerns-about-Extra-Territoriality)
- b. The Function of an Organised Trading Facility  
[http://www.wmba.org.uk/execution\\_policy/function-of-an-otf.pdf](http://www.wmba.org.uk/execution_policy/function-of-an-otf.pdf)
- c. The Importance of the OTC markets  
[http://www.wmba.org.uk/execution\\_policy/importance-of-otc-markets.pdf](http://www.wmba.org.uk/execution_policy/importance-of-otc-markets.pdf)
- d. What is an IDB and what value do they add to the market infrastructure?  
[http://www.wmba.org.uk/execution\\_policy/role\\_of\\_name\\_passing\\_broker.doc](http://www.wmba.org.uk/execution_policy/role_of_name_passing_broker.doc)
- e. MTFs and Electronic Matching Operated by WMBA and LEBA members  
[http://www.wmba.org.uk/execution\\_policy/mtfs.pdf](http://www.wmba.org.uk/execution_policy/mtfs.pdf)