ECSDA
European Central Securities Depositories Association

15 June 2012

Comments on the CPSS-IOSCO assessment methodology and disclosure framework for financial market infrastructures

ECSDA welcomes the two CPSS-IOSCO consultative reports on the assessment methodology and disclosure framework released on 16 April 2012 together with the final version of the Principles for financial market infrastructures. ECSDA represents 41 (I)CSDs across Europe, thus our comments focus on CSD-relevant provisions and on the relationship between the proposed CPSS-IOSCO Principles and European standards.

European CSDs are fully committed to transparency and share the aim of global convergence. ECSDA itself encourages all its member institutions to regularly publish disclosure reports based on internally-recognised formats. Our website provides an overview of such reports at: http://www.ecsda.eu/site/disclosures.html

1. General comments

ECSDA understands that the proposed assessment methodology (AM) and disclosure framework (DF) have two different purposes, being addressed to regulators and to infrastructures respectively. However we wonder whether the difference in formats (questions in the case of the AM, headings with narrative descriptions in the DF) will not create additional complexity and duplication when complying with the FMI Principles. In particular we fear that the narrative format being proposed in the new DF will not enhance transparency compared to the former disclosure framework as it relies entirely on "free text" responses which will make comparisons between different infrastructures quite difficult.

In fact, we believe that a more efficient and transparent solution for FMI disclosures would have been to use the AM as a basis for FMI self-assessments, possibly taking out some AM questions if the related responses require confidential information and thus cannot be made publicly available.
The question format has the advantage of achieving more standardised and comparable responses (e.g. yes/no questions with subsequent supplementary comments, multiple choice, etc.). It could also have facilitated efforts to achieve global convergence of existing disclosure questionnaires, including

the Association of Global Custodians (AGC) questionnaire which, in the case of CSDs, partly overlaps with the CPSS-IOSCO framework. CSDs are expected to publish a yearly (or at least biannual) update of both the AGC and CPSS-IOSCO disclosure frameworks, which for respondents represents a considerable administrative burden. Such a burden would be reduced if all disclosures would be required as part of a single questionnaire to be completed by CSDs on an annual basis, and in a standardised format to allow for easier comparison across countries and over time.

ECSDA thus fully supports the World Forum of CSDs (WFC)'s proposal to either redraft the proposed DF in such a way that it becomes a subset of the AM or to allow FMIs to use the AM questions as a basis for their annual disclosure exercise (rather than the DF template currently being proposed), especially if they are required to complete self-assessments by their national regulators and provided that they disclose the same level of information as they would under the proposed DF. ECSDA insists that it does not aim in any way to reduce the scope of the CPSS-IOSCO framework (DF and AM), but rather to avoid unnecessary duplication of the work.

At the European level, CSDs will soon be subject to a regulation of the European Union which will in part translate CPSS-IOSCO Principles into legally binding requirements.
For ECSDA, it is very important that the upcoming EU regulation on CSDs is fully consistent with the new CPSS-IOSCO Principles and that the supervisory framework to be put in place is in line with the CPSS-IOSCO assessment methodology to avoid inconsistencies in implementation. We would like to avoid a situation whereby national regulators could cherry-pick between the FMI Principles and the EU regulation when constructing their local regulatory regimes.

Finally, ECSDA would welcome an initiative to review and align the Eurosystem User Standards for SSSs with the new CPSS-IOSCO Principles.

2. Comments on the disclosure framework

The DF requires respondents to *"indicate the extent to which each response is relevant to each FMI category".* As most CSDs operate a securities settlement system (SSS) as part of their core business, responses to the DF should be considered to cover both the CSD and the SSS (e.g. governance, legal basis…) unless otherwise specified.

ECSDA supports CPSS-IOSCO's recommendation that FMIs should publish their responses to the DF on their websites. However, we note that in some cases, it could be difficult for FMIs to provide comprehensive responses to the DF without releasing confidential information. This will have to be taken into account for a number of "key elements" of the DF for which FMIs should only be expected to publish a high-level overview of methods rather than specific information (such as results, exact

numbers or scenarios for questions concerning confidential information). This is especially true for the following:

- Principle 3 on a framework for the comprehensive management of risks: key elements 9 (identification of the scenarios that may potentially prevent the FMI from being able to provide its critical operations and services) and 10 (preparation of appropriate plans for recovery or orderly wind-down);
- Principle 4 on credit risk: key elements 6 (coverage of current and potential future exposure to each participant), 14 (analysis of stress-testing scenarios, models, and underlying parameters and assumptions), 16 (identification of scenarios for stress testing financial resources) and 18 (process for the replenishment of financial resources during a stress event);
- Principle 7 on liquidity risk: key elements 4 (quantification of the minimum liquidity resource requirement in each currency), 5 (quantification of additional liquidity resource requirements), and 20 (analysis of stress-testing scenarios, models, and underlying parameters and assumptions);
- Principle 17 on operational risk: key elements 11 (business continuity plan), 12 (crisis management and communication) and 13 (adequate secondary site)
- Principle 19 on tiered participation arrangements: key element 3 (identification of key indirect participants).

Regarding section II. B of the DF template on “key metrics”, ECSDA would like to suggest that, in case CSDs are expected to provide basic figures such as the volume and value of transactions they have settled in a given year, as well as the value of assets held in custody at year end, they should be encouraged to use a harmonised methodology, to ensure comparability of disclosure reports. For example, CPSS-IOSCO might consider whether to recommend that CSDs disclose a few basic indicators based on the “Red Book” methodology developed by the CPSS.

Since the Principles will be used for the first time by regulatory authorities in 2012 and given that the publication of disclosure reports based on the new DF template will require substantial work from FMIs, ECSDA suggests that CSDs and other FMIs should be expected to publish their first disclosure report based on the new DF as of end 2013.

As mentioned in the General remarks, ECSDA would like to draw CPSS-IOSCO’s attention to the benefits that could be gained from efforts to consolidate existing frameworks for the disclosure of CSD information, and in particular the CPSS-IOSCO DF and the annual AGC's depository information-gathering project (DIGP), in which all ECSDA members participate each year. The existence of parallel questionnaires and disclosure requirements represents a considerable administrative burden for CSDs, especially for smaller institutions. While it is not our intention to reduce the level of disclosure being provided or the number and scope of questions being asked, we strongly believe that the replacement of overlapping requirements by a single global annual disclosure questionnaire on CSDs would considerably enhance market transparency as well as the quality (rather than the quantity) of the information provided. The finalisation of the CPSS-IOSCO thus represents a unique opportunity to

achieve a single global questionnaire satisfying both CPSS-IOSCO and AGC's requirements and to avoid creating yet another layer of complexity.

3. Comments on the assessment methodology

The AM foresees that *"FMIs may have to conduct formal period full or partial self-assessments of observance of the principles"*. Many European CSDs currently perform such self-assessments based on the CPSS-IOSCO framework but are worried that in the future they might need to duplicate the work if they are asked both to use the AM as a basis for self-assessments and the DF. Given that the objective in all cases is to provide evidence that the FMI is complying with the CPSS-IOSCO Principles, the AM and DF documents should clearly state that FMIs should only be requested either to provide self-assessments based on the AM or to provide self-assessments based on the DF.

As regards the rating framework, ECSDA believes that it plays an important role to ensure consistent implementation across jurisdictions. However, the effectiveness of the ratings will be reduced if national authorities opt to use a different rating system. Furthermore, the way in which "issues of concern" contribute to determine the appropriate rating should probably take into account, not only the number of issues, but also a certain degree of materiality as regards key considerations which are not fully observed.

Given the additional requirements contained in the PFMI compared to the former SSS recommendations, ECSDA also suggests that a review mechanism might need to be established in order to assess whether all Principles are working in practice, and which key considerations might need to be adjusted in light of the experience gained in the first years of implementation.

ECSDA represents 41 (I)CSDs in 37 European countries. We trust that our comments will be taken into consideration by the CPSS and the IOSCO Technical Committee when reviewing the Disclosure Framework and Assessment Methodology before final publication. For any questions on this paper, please contact the ECSDA Secretariat at +32 2 234 63 13 or email soraya.belghazi@ecsda.eu.