



11 October 2013

## **WFC Response to the CPSS-IOSCO consultative report on Recovery of financial market infrastructures**

### **Introduction**

The World Forum of CSDs (WFC) welcomes the CPSS-IOSCO Consultative Report on the Recovery of financial market infrastructures issued on 12 August 2013. The WFC is composed of the following five regional CSD associations that, together, represent more than 125 member CSDs:

- Asia-Pacific Central Securities Depository Group (ACG)
- Americas' Central Securities Depositories Association (ACSDA)
- Association of Eurasian Central Securities Depositories (AECSD)
- Africa & Middle East Depositories Association (AMEDA)
- European Central Securities Depositories Association (ECSDA)

As a result, our response focuses on the CSD-relevant aspects of the CPSS-IOSCO report. We support the view that each FMI will need a unique set of tools based on the specific market structure it operates in. We also welcome the needed and helpful clarifications stemming from the July 2012 report, and we are grateful to CPSS and IOSCO for having taken into account the comments made by WFC and other respondents to the 2012 consultation.

### **1. CSDs should have sufficient discretion and flexibility to choose the most appropriate tools and their sequence**

The WFC welcomes the recognition by CPSS and IOSCO under section 2.3.4 that ex ante binding arrangements on the replenishment of the CSD's financial resources are not always possible or appropriate in recovery plans (for example, ex ante commitments from shareholders or from participants to raise additional capital).

More importantly, we think it is essential that CSDs retain some discretion in determining the sequence with which recovery tools are used. Indeed, CSDs are different from CCPs in that they typically do not have a "default waterfall", and in case of a major crisis, it is important that recovery of a CSD is not hampered by a rigid sequence that might not be appropriate to the particular situation. We welcome the recognition by CPSS and IOSCO that tools and the sequence of tools should be adapted to the specific circumstances, but we think this point could be stressed further under section 3.1, to make it clear that the recovery and resolution plan (RRP) of a CSD should not necessarily include a prescribed sequence of events.



We believe it is essential that each CSD be able to determine which recovery tools are appropriate to its business model and particular situation. We thus fully support the recognition by CPSS and IOSCO that discretion is necessary in the selection of recovery tools.

## **2. The report should clarify which tools apply to which type of FMI**

While some recovery tools covered in the report will never be applicable in the case of CSDs, others are likely to apply to most CSDs. Others might only be relevant for a few CSDs, such as those operating under a banking license.

To facilitate implementation, the WFC suggests that CPSS and IOSCO add a summary table, similar to the one contained in Annex E of the PFMI report, specifying which tools may (but do not always have to) be used by each type of FMI.

## **3. The report should recognize that loss sharing will in many cases not be applicable to CSDs**

Most CSDs are not exposed to material credit risk in relation to their participants and their viability should thus not be affected by the default of a participant. In fact, a CSD's exposure to its participants is generally limited to the non-payment of fees, which has less of an impact from a recovery planning perspective. Many tools listed in the report focus on the effect of participant defaults, and will thus not be applicable to most CSDs.

Loss allocation, in particular, could create inappropriate incentives in the case of CSDs. Indeed, the requirement for participants to share in the losses caused by the default of another participant could lead these participants to reconsider their relationship with the CSD, potentially resulting in the usage of less regulated entities which are not subject to loss allocation for services similar to those provided by CSDs.

The WFC thus recommends that measures on loss allocation, and the principle of full allocation, should not systematically be applied to CSDs (including to those CSDs exposed to limited credit risk), especially when other valid recovery arrangements are in place.

Position-based allocation tools, as described under Sections 3.5.9 to 3.5.13, have traditionally been associated with CCPs, and we are not aware of precedents regarding the use of such tools for CSDs. To avoid discouraging direct participation in CSDs, the involvement of "indirect participants" in loss allocation would have to be considered, but is likely to raise a number of legal and operational difficulties given that CSDs only have contractual relationships with direct participants and given that they often do not have access to information regarding the clients of their participants.



#### **4. The distinction between recovery and resolution could be clarified**

The WFC supports the general approach of Section 2 of the report on recovery planning, especially the focus on identifying and maintaining critical services in recovery. In Section 2.2, we believe that the report could stress more explicitly that resolution should only be launched once insolvency can no longer be avoided.

#### **5. CSDs should communicate transparently to their participants, but the full recovery plan should not be a public document**

The WFC agrees that the rules and contracts of a CSD should be transparent with its participants regarding risks that participants face directly from the execution of such contracts, including as a result of the CSD's default and recovery procedures. In the case of CSDs operating with a banking license and granting short-term credit to participants against collateral, it is especially important that contracts be clear about the use of participants' collateral and about the default allocation processes impacting defaulting and non-defaulting participants, if any such processes are in place.

We note however, that the recovery plan is not aimed to be a public document, and that some of the detailed processes involved should not be shared with participants or the general public.

#### **6. CSD recovery plans should consider the impact of recovery on third parties, taking into account limitations on access to information on third parties**

The cover note to the CPSS-IOSCO consultative report calls for comments on the "impact of recovery tools on direct and indirect participants". The WFC understands the need for CSD recovery plans to take into account the impact of recovery measures on CSD participants and the wider market, especially when determining which tool is most appropriate in a given situation. We would like to stress, however, that it is the responsibility of participants, owners, linked FMIs and any other stakeholders (such as settlement banks) to establish an aggregate view of the risks they take in relation to all counterparties, including CSDs, and to monitor these risks against their risk appetite. It is also important to keep in mind that CSDs often have no control and no visibility on their clients' clients. They do not have the tools (legally or operationally) to identify and gather information on indirect participants, and thus do not usually have sufficient information to assess the potential impact of recovery measures beyond direct participants. The WFC therefore recommends that any requirement on a CSD to analyze the impact of recovery tools on indirect participants should only apply where the CSD has access to information on such parties.

Furthermore, Section 2.4.14 refers to the impact of recovery on links between financial market infrastructures, but does not distinguish between different types of links. The WFC would like to stress that the level of interdependence created by links between CSDs is much lower than that resulting from CCP links, and that the impact of recovery on standard CSD links is likely to be minimal, compared to other, more complex forms of links.



## About the WFC

On April 15, 2011, at the closing of the CSD11 conference in Cape Town, South Africa, the five regional CSD associations announced the formation of the World Forum of CSDs (WFC) in order to further enhance inter-association communications. The WFC provides a forum for regional CSD associations to exchange information, discuss issues of common interest and increase their influence and engagement on cross-regional and global developments.

The Forum has a Board composed of 10 members, namely the Chairs and Vice-Chairs of each of the five regional associations. Mr. Eddie Astanin of NSD (Russia) is currently acting as WFC Chairman, with Mr Mohamed Abdel Salam of MCDR (Egypt) as Vice-Chairman and Mr. Yoshinobu Takeuchi of JASDEC (Japan) as Honorary Chairman.

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