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Zürich, 15 July 2011

CONSULTATIVE REPORT ON PRINCIPLES FOR FINANCIAL MARKET INFRASTRUCTURES

Dear Sirs

SIX SIS AG (SIX SIS), is writing to you in response to the above consultation. We thank the CPSS and IOSCO for launching the consultation on this important issue at this time and for the opportunity of responding to it. We notably appreciate the length of the consultation period, and the opportunity to engage with the CPSS Secretariat, and our national overseer, the Swiss National Bank. While SIX SIS is part of a wider infrastructure group (see below), we are replying from the position of a CSD. A separate response will be submitted from a CCP perspective, by SIX x-clear AG. SIX SIS is (i) both an issuer and investor CSD, (ii) the operator of the securities settlement system SECOM, and (iii) as a provider of a wide range of CSD services, including safekeeping, custody and banking-type services. We are also members of ECSDA and the WFC, whose positions we also support.

Why are SIX SIS interested?

SIX SIS offer, as a CSD, settlement, custody and asset servicing to clients throughout Europe. We are both an Issuer and an Investor CSD. As part of the SIX Group (see below), we are strong promoters of an open market, encouraging links and access throughout our open architecture model. SIX Swiss Exchange is one of the top 5 largest regulated equity markets within Europe and we operate the largest warrants and structured products market within Europe – Scoach, as well as the derivatives exchange, Eurex¹, both as joint ventures. In the clearing segment, SIX x-clear AG is active as a CCP service provider across Europe, with SIX x-clear AG and LCH.Clearnet Ltd being the first interoperable CCP's in Europe in support of Swiss Blue Chip Securities since 2003 and extending this interoperable service to the London Stock Exchange in 2008. This arrangement has now been revised and extended. So we have widespread experience of the trading, clearing and settlement of securities in the major European markets and in controlling and mitigating the risks arising from them.

About the SIX Group

SIX SIS are part of the SIX Group AG which operates Switzerland's financial market infrastructure and offers on a global scale comprehensive services in the areas of securities trading, clearing and settlement, under the brand of SIX Securities Services, as well as financial information and payment transactions. The company is owned by its users (150 Swiss and foreign banks) and, with its workforce of approximately 3,700 employees and presence in 23 countries, services 62 markets globally, and generates annual revenues of the equivalent of approximately 1.2 billion Swiss Francs.

¹ This stake will be sold effective 1 January 2012

Executive Summary and Overall Approach

We understand the reasons behind the revision of the Principles, but would note, however, that during the recent financial crisis market infrastructures proved themselves to be very resilient. The Principles should be mindful of the need to ensure that market infrastructures do not lose the capacity to support the official sector and the market in general, and indeed to react dynamically to the demands of the market, e.g. through product innovation. In particular, in terms of our general comments, we believe that:

- (i) By being combined, the revised Principles lose the clarity of the separate SSS Recommendation and CCP and CSD Principles from 2001 and 2004;
- (ii) They appear to be too CCP-centric, for instance in terms of focussing on participants' clients risk (as required for a GCM for an NCM), which is inappropriate in the CSD context;
- (iii) We are hampered, at this juncture, in our analysis by the absence of an Assessment Methodology;
- (iv) We believe that the "Key Considerations" under each Principle should be viewed as guidance or a guideline, and not as a prescriptive requirement. As a guideline, each Key Consideration could then be subject to a "comply or explain" regime;
- (v) We also draw CPSS-IOSCO's attention to the need to ensure consistency in the global application of the Principles, while at the same time ensuring that the characteristics and features of local markets are taken into account. In particular, we suggest that the finalisation and implementation of the Principles needs to be closely aligned with forthcoming European Union legislation on CSDs; and
- (vi) Some of the proposed risk mitigation requirements, in the interdependencies risk, in "drilling down" beyond the monitoring of participants, to their clients and the transaction flows over their accounts strike us as excessive, and would carry with them a significant cost of re-engineering systems, processes and enhancing physical resources; we suspect that this is not "doable". We believe that there is a risk that, apart from the significant cost implications, that these requirements could potentially make the markets in the developed world, including Europe, unattractive, and encourage clients to move these transactions either to other less intensively regulated centres or into more opaque structures.

In terms of replying to the questions asked of FMIs in the accompanying Cover Note, we would reply as follows:

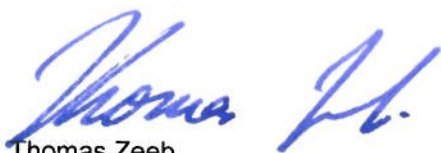
- (i) Credit, liquidity and default risk: we support mandating a "cover 2" minimum requirement for CSDs. These two participants should be the two largest to which the CSD is exposed;
- (ii) we support setting a minimum quantitative requirement for liquid net assets funded by equity of 12 months of operating expenses; and
- (iii) we support open and fair access to CSDs (and for CCPs we believe that inter-operability is the way to go).
- (iv) Cost: we have begun the process of discussing the application of the Principles with our overseer. We draw CPSS-IOSCO's attention to significant adaptations, for instance in relation to the introduction of Target 2 Securities in Europe (and in our case other in house adaptations, involving the re-engineering of SECOM, our securities settlement, and SIC, our payment, systems), as well as the forthcoming EU legislation mentioned above. For our part therefore, we would argue for the Principles being either (a) prioritised and brought in sequentially (starting with risk management), with other aspects such as communication given lower priority, or (b) applied in their entirety no earlier than 2015. In this regard the Assessment Methodology will be crucial.

We hope these remarks are of help. As noted at the beginning, this response covers a CSD-centric response to the Principles consultation from SIX SIS AG. We understand that comments have already been made by, and on behalf of, the Swiss interbank payment system SIC, and we anticipate that there will be a further reply from our CCP, SIX x-clear AG.

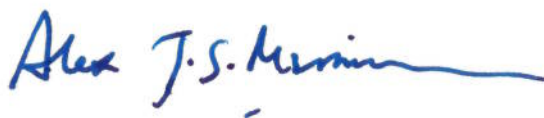
If you require any further information at this stage, may we suggest that our Head of Market Policy, Alex Merriman (contact: Alexander.Merriman@six-group.com or on +41 58 399 4583) would be pleased to assist.

Yours sincerely

SIX Securities Services



Thomas Zeeb
Chief Executive Officer



Alex Merriman
Head of Market Policy

SIX SIS AG (SIX SIS) RESPONSE TO CONSULTATIVE REPORT ON PRINCIPLES FOR FINANCIAL MARKET INFRASTRUCTURES

[SIX Securities Services cover the clearing, settlement and custody arms of the SIX Group AG. This reply is from SIX SIS AG, the CSD of the SIX Group]

GENERAL ORGANISATION

Principle 1: Sound legal basis

We have no particular comment to make on this section, and believe we currently meet the requirements to identify the necessary legal underpinnings to our business. The content of our contracts with individual clients and SLAs are reviewed on a regular basis.

Principle 2: Governance

We believe we have an appropriate governance structure, consisting of Executive and Supervisory Boards, where there is a strong Independent Non-executive Director representation, and an appropriate committee structure. This is underpinned by a comprehensive programme of both internal and external audit. The Board structure is at the level of the SIX Group itself. The SIX Group is also user owned, with participation across the entire Swiss banking landscape, including foreign banks. Our understanding is that – as noted in footnote 27 on page 25 – that the Principles expressly recognise that there are alternative means to enhance the board’s ability to exercise independent judgement through a dual (advisory or supervisory) board structure. We also share the view in the report that there is no one single model of governance for financial market infrastructure that is preferable to another. We understand that the concept of governance, as far as central bank overseers are concerned, also encompasses the notion of wider conformity with the market and market participants. In this respect we draw CPSS-IOSCO’s attention to the comments we have made below in relation to Principles 21 and 23.

RISK MANAGEMENT

Principles 3 (Overall RM Framework), 4 (Credit Risk), 5 (Collateral), 7 (Liquidity Risk)

We agree that a CSD should manage its financial risks prudently and we systematically monitor clients’ exposure to credit, liquidity and other risks. We do not think that the offering of credit (i.e. banking-type services) poses any special risks, as long these are monitored in real time and are actively managed. We do not offer uncollateralised overnight credit, and intra-day credit is secured by means of a lien (with appropriate haircuts) on the participants’ assets. This lien is fully enforceable in the event of non-return of cash by the participant. If you are a bank like SIX SIS, and you operate a real time (not overnight batch) RTGS system, with final settlement across the books of the central bank, then there is a need for short-term credit facilities to smooth participants’ transaction and payment flows. We advance that operating a batch system (with overnight settlement) is systemically more risky.

We are also not in the business of creating large additional amounts of liquidity outside the requirements of the settlement system, and do not encourage our clients to deposit excess cash surpluses with us. We have never experienced a liquidity drain and believe that our system is comprehensively robust.

We note that the authorities have introduced the notion of an additional risk management tool that FMIs should monitor closely the linkage between credit and liquidity risks in the operational systems that they manage. While maintaining detailed individual credit and liquidity risk management policies, this linkage is not something that we currently examine and the report has spurred us to look at this aspect anew.

As mentioned in our covering letter, we believe that management of credit and liquidity risks should encompass the ability of the infrastructure to withstand the loss of its two major participants; in other words the “Cover 2” principle.

On the subject of **stress-testing**, we have examined CPSS-IOSCO’s recommendations carefully, in relation to both liquidity and credit risks. In the CSD case, we stress-test from a credit perspective, but generally do not from a liquidity point of view: and we are looking at this aspect again. It would be fair to say, however, that we monitor the liquidity risk run by participants and that most of the liquidity risk is indeed taken by market participants. We suggest that the need to stress test these risks should be balanced against whether these tests will lead to any additional, important information, in the management of our risk exposures, that we would otherwise miss. We currently do not think this is the case. We have also noted the authorities’ desire to see FMIs also stressing their exposures along the whole value chain and similarly believe that this needs to be proportional to any additional benefits.

In relation to Principle 5 on Collateral, we note, in paragraph 3.5.1, the requirement that “intraday credit should be collateralised to cover the principal amount with a high degree of confidence”. We draw CPSS-IOSCO’s attention to the situation in the Swiss market whereby intraday exposures are secured by SIX SIS by virtue of a pledge or *lien* over the collateral provided by a participant. This lien is fully enforceable in Swiss Law until the participant has repaid the intraday credit (or in the event of insolvency of the participant). Taken together with the acceptance of “a guarantee fully backed by collateral” in footnote 44 on page 28 of the report, we seek confirmation that this meets the requirements of Principle 5.

Principle 6: Margin

This Principle does not apply to CSDs.

SETTLEMENT

Principle 8: Settlement Finality

Settlement finality is governed in the Swiss market by the robust provisions of the FISA 2008 (Bucheffectengesetz, BEG). We have not experienced any legal uncertainty or difficulty with this legislation, which transcribes the salient features of both the – internationally-recognised - Hague and Geneva Conventions into Swiss Law.

Principle 9: Money settlements

We welcome the explicit confirmation from CPSS-IOSCO (in paragraph 3.9.2) that settlement in commercial bank money remains a viable option, even though (some) overseers would prefer market infrastructures to settle solely in central bank money. Settlement in commercial bank money is desirable for a variety of situations, for instance from the perspective that system participants may not always have access to central bank money (e.g. they do not maintain an account at the central bank) and particularly cross-border corporate action transactions, when central bank money may not be available. To do otherwise will severely restrict the availability of liquidity for infrastructure and participant alike. We also stress that the underlying risks are no less monitored and controlled than for settlement in central bank money. In essence, settlement in commercial bank money is governed by equivalent parameters to settlement in central bank money, notably appropriate daylight counterparty limits and caps, real-time monitoring, and appropriate security and queuing arrangements. We believe that the requirements in paragraph 3.9.5 would therefore be met.

We note also from paragraph 3.9.6 and footnote 71 on page 56 that CPSS-IOSCO advance the that an FMI engaging in (commercial bank) money settlement across its own books might establish itself as a special purpose institution and indeed may be required to hold a banking license. We note that this aspect (of “banking-type services”) is also under active consideration in terms of the forthcoming European Union Legislation on CSDs, which should issue later this year. While we agree that it might be desirable to countenance a banking license for such activity, we believe that ring-fencing such activity into a separate legal entity would not be appropriate. As a holder of a banking license, we are already subject to prudential supervision by the Swiss supervisory authority, FINMA, both on a solo and consolidated basis.

Principle 10: Physical Deliveries

We are active in physical deliveries. Many bearer shares are in physical form in the Swiss market and there is considerable activity both “in” and “out” of our vault, including in the category of “Schuldbriefverwahrung”. Individual safe keeping for our clients, also includes the acceptance of “envelopes”. This is subject to appropriate checking and reconciliation procedures.

CSDs AND EXCHANGE OF VALUE SETTLEMENT SYSTEMS

Principle 11: CSDs

We believe we generally meet this CSD-specific principle and notably to ensure the integrity of securities issues, in ensuring the correct safekeeping (via dematerialisation and immobilization) and transfer of securities (by book entry).

In relation to paragraph 3.11.5 on **segregation of assets**, we nonetheless comment on the positive features of using omnibus accounts, which are, from our perspective, just as effective at controlling client risk as a segregated account. We question the need for an elaborate

system of physical **segregation** of proprietary assets, assets belonging to the participant, and the participant's customers' assets. In particular, CSDs are not set up to segregate participants' clients' assets. To introduce this requirement would impose a significant burden on CSDs. This segregation can be equally well achieved through proper control and monitoring of account balances, together with robust underpinning law, which ensures that if there is any doubt about the ownership of assets held in an omnibus account, then these default to the participant, or to the participant's client. Although, as a CSD, we have the means to segregate adequately our own assets and those in our clients' omnibus account, we believe that it is up to the participant in a CSD to undertake a proper distinction between their own proprietary assets and the assets belonging to their clients. Forcing CSDs to segregate their participants' clients' assets will be very costly in terms of systems adaptations. The CSD can offer an appropriate accounting structure/system, but should not be made responsible for the client's mistakes.

Principle 12: Exchange-of-value systems

Our securities settlement system is underpinned by DvP. On settlement date, the financial instruments are transferred in our securities settlement system, SECOM, while the related payment is made simultaneously either through the Swiss Interbank Clearing (SIC) system or through the SIS money accounts in SECOM (where neither transacting party is a SIC participant). Payment only takes place, if the financial instrument is transferred.

DEFAULT MANAGEMENT

Principle 13: Participant default rules and procedures

We believe these are adequate. Since settlement takes place on a DvP basis and intra-day credit is collateralised, together with the imposition of haircuts on the collateral, we believe we are comprehensively protected against potential loss.

Principle 14: Segregation and Portability

We understand that this Principle does not apply to CSDs. But see also our comment on segregation of CSD accounts under Principle 11. In terms of the domestic market, portability is not relevant at the level of the direct participant in the SSS, though of course a participant's client does have choice, in the same way that a NCM does have choice of GCMs.

GENERAL BUSINESS AND OPERATIONAL MANAGEMENT

Principle 15: General Business Risk

We support the requirement that CSDs should be well capitalized to withstand non-financial losses and other capital shortfalls. As mentioned in our covering letter, we believe that the appropriate level for the minimum quantitative liquid net assets or equity test should be equivalent to twelve months' operating expenses. We approach this from the perspective of not only the infrastructure being able to demonstrate tangible capital strength (which we need to do as we are licensed as a bank), but also the length of time that a CSD might require, in

the event of closure or wind down, in order to effect an orderly transition to successor arrangements.

Principle 16: Custody and Investment Risk

Swiss Law provides that where there is any doubt, between the CSD and the participant (or the participant's client), over the ownership of assets (in an omnibus account), the default is that the asset belongs to the participant or the participant's client. Swiss law also clearly distinguishes between the assets belonging to the participant and the participant's client. As mentioned above, this provides a robust incentive for the CSD to manage its participant accounts in a risk- and error- free way.

Principle 17: Operational Risk

We believe we have a comprehensive framework for monitoring, reporting and reviewing operational risk, and subjecting this to both Executive and Supervisory Board review, as well through an extensive programme of both internal and external audit. As the operating systems of SIX SIS are designated by our overseer, the Swiss National Bank, as a critical infrastructure for the Swiss market, business continuity planning arrangements are subject to review by the Swiss National Bank, at least annually. Regular review entails the regular examination of the appropriateness of existing arrangements. We are in the process of reviewing our requirements for the maintenance of a secondary stand-by site, as well as the use of stand-by generators. This is overseen by our Executive Board and subject to approval by our overseer.

While the tasks can be outsourced or delegated to third parties, we agree that the CSD must retain ultimate responsibility and control for these tasks. In the CSD world, and as an authorized institution, outsourcing of critical functions should be subject to prior supervisory approval. Outsourcing arrangements are governed by the relevant ordinance from our supervisor, FINMA. We query, however, the further extent to which we should monitor the financial or other condition of critical outsource providers. This could be very resource-intensive. These relationships are based on contractual agreements and are subject to a number of conditions. Were the conditions to be breached, for instance through failure by the provider to deliver to the standard required, or in the event that the provider was no longer able to deliver the service required, e.g. through insolvency, this would result in the cancellation of the contract. What seems more pertinent to us is that the infrastructure should be clear on contingency arrangements, on how it would replace a failing critical outsource provider, for instance by maintaining an awareness of possible substitutes. One example of this is the event of power interruption, where the power source can be replaced by electricity sourced from diesel generators.

ACCESS

Principle 18: Access and Participation Requirements

We support open and fair access to FMIs, including CSDs. As noted in our covering letter, the SIX Group AG operates an open architecture model, encouraging links and access

throughout the value chain. Access and participation requirements must be proportionate, measurable and transparent. Where access has been turned down, it has usually occurred because the requesting entity has not met the admission criteria.

Principle 19: Tiered participation arrangements

Please also see our comment under Principle 14. We accept the need for a CSD to monitor the activity over its participants' accounts, and to safeguard its clients' assets. However, the extent of drilling down to understanding the principal causes of the participants' client activity (for instance, the underlying transactions that drive the participants' settlement flows) strikes us as excessive. For two reasons: (i) as previously mentioned, this will require costly system and process adaptations way beyond the benefit to the CSD in terms of enhanced risk management, and is it really "doable"; and (ii) we believe that, for the CSD, this would introduce a conflict of interest and competitive distortion, in the sense that we would be able to analyse the participants' client business in more detail and might be tempted ourselves to offer direct services to that participant's client. This is undesirable. This monitoring should, in our view, be limited to ensuring that the business is legitimate, and meets relevant requirements in terms of KYC and AML. As previously discussed, as well as monitoring and mitigating participant risk (e.g. through caps and limits), CSDs provide and manage an account facility for a participant (in the manner in which the participant requires); this does not extend to managing the risks of the participants' clients.

Following discussions in various fora organized by the CPSS, we understand that overseers are not looking to FMIs to monitor the client activities of every single participant over a securities account. There should, instead, be an appreciation of the scale and scope of that indirect participant's business and the impact on the CSD in the event of failure or disruption. There is then the question of where the FMI should draw the cut off point for assessing these potentially "risky" indirect participants, and indeed where a judgment needs to be made about whether an indirect participant should be encouraged to become a direct system participant. We look forward to discussing and refining these aspects further.

Principle 20: FMI Links

CSD to CSD links are already very common and arise through a business case. For instance, SIX SIS already enjoys links with Euroclear, London and Brussels (ESES), Clearstream Frankfurt and Luxembourg, VP Denmark, OeKB, Monte Titoli and Keler. All of these entities are authorized in their respective domestic markets. In addition, technical interfaces such as Link-up Markets have facilitated the development of direct cross-border access between CSDs, both inside and outside Europe.

We note CPSS-IOSCO's comments about the degree of reassurance required when an investor CSD connects into an issuer CSD, and therefore may put at risk assets belonging to the investor CSDs' participants. We assess the vulnerability of such links in the same way as we assess our other counterparty risks, as for any CSD to CSD link. We do not believe that the amount of "drilling down", as described in paragraphs 3.20.6 and 3.20.7, for instance in relation to segregation and portability, or in relation to assessing the adequacy of the counterpart's business continuity arrangements, as described in paragraph 3.20.9, will

materially improve our understanding of the risks that the investor CSD is exposed to. Such investigation would be materially resource-intensive, and add to costs.

EFFICIENCY

Principle 21: Efficiency and effectiveness

We believe we meet the requirements and needs of the Swiss market and our international clients, as well as having overall goals, and subjecting our business model to review on a regular basis. Some examples:

- (i) We have recently revised our (Securities Services) user advisory committee structure, with notably the creation of a Senior Advisory Board (SAB). The bodies beneath the SAB are also being refined and their terms of reference being re-written to reflect the changing needs of users and the market;
- (ii) We are currently in discussion with our users and the Swiss market over the updating of our key operating systems, SECOM and SIC;
- (iii) We have fully engaged with our users over the impact of Target 2 Securities on the business of SIX SIS and the Swiss Market, notably through bilateral and multi-lateral discussion, also involving our overseer, the Swiss National Bank. This has notably involved the exploration of various options in settling euro and CHF balances in T2S;
- (iv) Annual profitability and business volumes, as well as financial (e.g. EBIT) performance, targets, are set, monitored and refined on an annual basis, as part of the annual budget cycle (internal reporting is monthly); and
- (v) Strategy is discussed formally at least twice a year at the level of the executive and supervisory boards of the Six Group AG. The Group's overall business model has been stress-tested against current market conditions in the last six months. More in-depth strategic discussions and decisions take place at the level of Securities Services itself on a quarterly basis.

Principle 22: Communication procedures and standards

We believe that we meet this Principle in the use of commonly accepted international standards such as ISO 15022, and the application of ISO 20022 in the future. In particular, we make a virtue of communication with our clients, and the market in general, via an extensive series of "Market Guides" (covering both products and geographical regions), as well as other web and electronic messaging formats, particularly when informing clients about the availability of interfaces, and in disseminating a wide range of other information. One of the adaptations in relation to SECOM (mentioned above) will be, at user request, the creation of a single GUI portal for all securities services.

TRANSPARENCY

Principle 23: Disclosure of rules and procedures

We believe that we currently meet these requirements particularly in terms of striking a balance between public disclosure and disclosing to participants more confidential aspects of procedures. We notably adhered closely to the provisions of the EU Code of Conduct for Market Infrastructures, introduced by the European Commission at the end of 2007. Our fees in particular are “unbundled”, our rebate and discount structures and policy are clear, and our clients can freely choose from a menu of products and services. We take seriously the responsibility of explaining, to our clients, the rules and procedures of the system, and particularly the training and educational aspects. Not only are new customers taken through in detail the underpinning processes and requirements of using our facilities, but we regularly hold refresher courses for existing clients, where the users of the interfaces with SIX SIS have changed.

Principle 24: Disclosure of Market Data

This Principle does not apply to CSDs.

SIX SIS AG
15 July 2011