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Contribution from EACH to the joint work of CESR and ECB in the field of clearing and settlement

The European Association of Central Counterparty Clearing Houses (EACH), which is affiliated to the Federation of European Securities Exchanges (FESE), is pleased to contribute to discussion of the issues raised in the 15 March paper of the Committee of European Regulators (CESR) and the European System of Central Banks (ECB). It looks forward to continued dialogue as the joint work progresses.

As the CESR-ECB paper notes, the issues grouped under '2.8 structural issues' have been vigorously debated in the recent past. The views of EACH/FESE members – and FESE membership has since the affiliation of EACH expanded to include clearing organisations that are not owned by FESE exchanges – differ on those issues and those already known differences will be reflected in separate contributions by the principal 'protagonists'. This contribution does, however, make some remarks on structural issues that are commonly held by the membership.

2.1 Nature of the recommendations
and
2.2 Addressee

Although we comment on these questions, and note that CESR-ECB's intention is to provide input to the European Commission, we are surprised that the regulators and central banks have begun their work before the Commission has arrived at any conclusion on what

it believes may be necessary in the field of clearing and settlement. The general feeling of EACH/FESE members is that it would have made more sense if the Commission had arrived at a conclusion first. There is, at least, the appearance of a lack of co-ordination.

Our view is that standards or recommendations relevant to central counterparty clearing houses (CCPs) should be addressed to operators of CCPs and national supervisors/regulators. We do not in practice see how they could not be addressed to the supervisors/regulators, as they constitute one half of the CESR-ECB group and are likely to find it difficult to disregard their own work: it would not be a good demonstration of their productivity. We note in this regard that the EACH standards of risk management controls – which we are pleased to see acknowledged as a reference point for the CESR-ECB – are comprehensive, relatively detailed and, on the basis of our discussions, widely met by European clearing houses. The inference that we would draw is that CESR-ECB may not have too much to do in respect of CCP standards unless its aim is to concentrate on the areas intentionally not tackled by EACH; those falling under structure and governance and the other issues raised under 2.8.

One member organisation feels that the current framework of national rules on clearing, assisted by inter-regulator co-operation at various levels, may not be adequate to enable the full, cross-border integration of clearing in optimal fashion. Its inclination is to favour CESR-ECB standards or recommendations addressed to the European Commission with a proposal that they should be translated into legislation. We would note that the Commission in any event has powers of initiative and will wish to take further soundings at various stages. At the same time, there is unanimous agreement that legislation carries inherent dangers of rigidity and inflexibility, especially when it is appreciated that the first US regulation covering clearing in any detail is less than twelve-months' old.

2.3 Scope

We agree with the proposal that there should be a functional scope embracing all those who provide similar services, and that there should be full coverage in terms of financial instrument.

We would also note that as the current thinking is to include commodity derivatives in the Investment Services Directive any standards in the clearing field should also apply to those instruments as well as to securities. Many EACH members already clear commodity business and apply the same risk management techniques in that area as for securities. It is not helpful to have standards or directives that have partial coverage in terms of financial instruments.

2.4 Objectives

We believe that the stated objectives are largely comprehensive and find it helpful that they are so clearly specified. One apparent omission is a reference to the creation of a level

playing field *between service providers* – objective 3 refers only to the evenness of the playing surface between participants and service providers. We infer that the reference is omitted because it is presumed that the standards will ensure the level playing field. Even if that is the case, we feel that the objectives of public policy should be complete. Although the basic landscape is European, members felt in our discussion of the paper that the objectives in respect of efficiency and level playing fields might usefully include international or global references. We note that the objectives are already very broad, but it seems nonetheless important to reflect a broader perspective in markets that are essentially global.

We would hope that the reference to investor protection in objective 1 does not presage any initiative to do more in that area, which EACH and FESE members feel is already fully dealt with.

2.5 Access conditions

The access conditions of particular relevance to CCPs are in respect of payment and settlement systems (CSDs). It is of increasing importance to CCP arrangements, which are progressively being extended to embrace cash (equity and bond) markets as well as those in derivative instruments, that CCPs have access to the full range of European CSD facilities on transparent, non-discriminatory terms.

2.6 Risks and weaknesses

EACH members do not feel that there are significant cross-border risks that are either not addressed in their risk mitigation techniques or reduced to residual proportions by domestic insolvency law provisions supported by the Settlement Finality Directive and related EU initiatives. More generally, we feel that the essence of CCP activity is that it essentially removes the domestic and cross-border dimension that we are aware has been such a prominent feature of discussions about CSD arrangements and is such a key area in pricing distinctions in the settlement arena.

2.7 Settlement cycles

CCP arrangements, insofar as they interact with securities settlement cycles, adapt to the requirements of the latter and have considerable flexibility. With that said, we believe that standardisation would be of more general benefit to users of settlement facilities. In connection with the complicated, extremely expensive and judging from US experience somewhat elusive target of T+1 settlement, we note as interested parties that the risk certainty offered by central counterparty arrangements can reasonably be viewed as an alternative approach.

2.8 Structural issues

As mentioned earlier, EACH has intentionally avoided comment on the debate concerning the ownership, governance and pricing policy of clearing facilities in Europe. FESE has equally not entered the debate, although its larger exchange members have been leading participants in their own right.

We can, however, offer at least some comment on the relationship between the organisational structure of CCPs and their risk management, which is of course of key importance to the systemic risk mitigation presented as the first public policy objective in 2.4. We believe that EACH's risk control principle 12 (risk management arrangements and resources) that emphasises the need for there to be senior, independent risk management specialists at all clearing houses, regardless of their ownership structure, is of considerable relevance. Equally, we do not subscribe to any crude supposition that a clearing house owned by a profit maximising exchange will trade-off risk management standards for greater throughput and income or that a clearing house owned by its clearing member participants will be persuaded by them to adopt lax risk management standards in order to lower capital costs.

Yours sincerely

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