

**Position Paper in Response to the  
CESR/ECB Consultative Report  
Standards for Securities Clearing and Settlement Systems  
in the European Union**

**1. General Remarks and Executive Summary**

Deutsche Börse Group welcomes and supports the CESR/ECB project to establish standards for securities clearing and settlement in the EU, as we are convinced that this will help to foster the integration of EU post-trade markets. As expressed in our response to the consultation document published in 2002, we feel that the adaptation and implementation of the CPSS/IOSCO recommendations for EU countries will help to monitor risks in clearing and settlement wherever they arise, and to break down existing barriers to cross-border clearing and settlement within the EU.

Even if the standards have – at least for the time being – no law status, we are convinced that the transparency generated as a result of their implementation, and particular as a result of the application of a detailed assessment methodology, will produce significant benefits. This will create a clear basis for cooperation between national authorities while guaranteeing a certain degree of flexibility for market participants. We leave open the question of whether the standards on their own will be sufficient or whether further measures, such as an EU Directive, will be required to ensure their uniform application. In any case, we warn against underestimating the complexity of the clearing and settlement processes. Consequently, the results of the implementation of the CESR/ECB standards should be thoroughly evaluated before any further legal measures are taken.

With respect to the goal of harmonization, we feel that the definition of the scope of the standards is crucial for achieving financial market safety and cross-border application. Regulating so-called “infrastructures” on the one hand while fully excluding “intermediaries” providing the same services from the scope of the standards on the other will not achieve the goal of harmonization, and therefore the distinction is not useful. Against this background, the func-

tional approach favoured by CESR/ECB is strongly to be welcomed. However, this does not mean that no further fine-tuning is necessary. In particular, care must be taken to ensure that custodians that do not concentrate significant risk, and that focus on domestic markets are not subject to the standards. A risk-based approach will have to be developed to identify the right target groups for the standards, and hence to avoid imposing unnecessary constraints.

Such a well-defined functional approach could help minimize the risk of redundancies as against banking regulation. The latter primarily addresses the insolvency risks of banks, whereas the CESR/ECB standards address overall market stability and efficiency based on the specific clearing and settlement function. To avoid misunderstandings, it would help if this distinction were made clearer both in general and in the context of specific standards.

In regard to the standards, which target institutions providing central counterparty services for securities transactions, we would like to draw attention to the need to take the specific nature of these services into account. Consequently, for example the Citibank White Paper published in July 2003<sup>1</sup> separated central counterparty clearing services from other services. In contrast to the clearing and settlement services addressed by the majority of the standards, the central counterparty services are closely related to the trading layer and exhibit certain particularities. CPSS/IOSCO are currently elaborating recommendations that specifically address these issues. As a result, Standard 4 and the extension of other standards towards CCPs should be postponed until the CPSS/IOSCO recommendations have been finalized.

With respect to the specific obligations on the providers of post-trade services, Deutsche Börse Group is aware of its responsibility to ensure overall market stability and efficiency. Clearstream and Eurex Clearing already meet the proposed requirements to the greatest possible extent.

We are in favour of the final version of the standards being presented and implemented as soon as possible. Nevertheless, it may be necessary to provide for a transitional period for the implementation of certain elements.

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<sup>1</sup> Citibank, Creating a Safe and Level Playing Field, White Paper, July 2003.

## 2. Market Structure and Scope of Standards

Before moving on to a discussion of the details, we believe it is important to accept the competitive nature of post-trade markets. As a for-profit enterprise active in the securities industry, Deutsche Börse Group is committed to competition. We believe that competition benefits customers and users by increasing efficiency and reducing transaction costs. This is confirmed, for example, by the first Giovannini Report,<sup>2</sup> which came to the conclusion that Clearstream Banking Frankfurt is among the CSDs with the lowest transaction costs in Europe.<sup>3</sup>

Consequently, it is misleading to make a distinction in the securities industry between different kind of service providers such as “infrastructures” and “intermediaries”. In particular, the fact that CSDs function in most countries as the end custodian for a financial instrument does not prevent competition with other service providers, since clearing and settlement can take place independently of the notary function. The clearing and settlement of German domestic bonds is an excellent example of this. Even if all German domestic bonds are held in final custody by Clearstream Banking Frankfurt in its capacity as the CSD, the majority of transactions are executed in intermediate settlement systems.

This shows that clearing and settlement can be performed both by the end custodian and by the intermediate custodian. Only the notary function, i. e. the statement of the assets in the customer accounts against the issuer position can be seen as a kind of “monopoly”. It is important to notice that – at least in Germany – the provision of the notary function is no legal monopoly which would prevent any existing or developing transactions banks or other CSDs the status as a “Wertpapiersammelbank”.

Against this background, we feel that it is legitimate to apply the standards not only to CSDs, but also to other systemically important service providers. A risk-based functional approach requires that the standards should apply to all relevant functions related to securities clearing and settlement business provided by these entities.

We are aware of the fact that the distinction between systemically important providers and other providers, i.e. custodians, implies the need to find a workable distinction between systemically important systems and “ordinary” agent banks. We have considered a number of cumulative qualitative and quantitative elements in examining whether it is, in practice, feasible to identify a class of “systemically important systems”, whereby the emphasis is on the first two qualitative elements:<sup>4</sup>

- the provision of multi-market links (i.e. a certain number of linked markets)
- a separate product offering for third parties
- (potentially) the ratio of internally settled transactions to externally settled transactions for different client groups (this needs further analysis against the background of the specific domestic market and/or the EU market as a whole)

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<sup>2</sup> Giovannini Group, Cross-Border Clearing and Settlement Arrangements in the European Union, November 2001.

<sup>3</sup> For an analysis of “cross-border equity trading, clearing & settlement in Europe” please see the Deutsche Börse / Clearstream White Paper, April 2002 (may be downloaded at [deutsche-boerse.com](http://deutsche-boerse.com)).

<sup>4</sup> For details, in particular regarding the specific standards that might be extended, please see Appendix.

Such a definition of the scope of the standards implies that the responsibility of infrastructure providers for the overall market is not restricted to “specifically regulated institutions” such as CCPs and CSDs. We believe that it is interesting to refer to current discussions of the Investment Services Directive, in which both the European Parliament and the Council have agreed on the responsibilities of investment firms that systemically internalize orders. This clearly shows that the borderlines between “infrastructures” and other providers are vanishing.

### **3. Comments on Specific Standards**

#### **Standard 1 – Legal Framework**

We agree that systemically important systems should operate on a well-founded, clear and transparent legal basis. In principle, the key elements are feasible. However, we have some concerns about the Explanatory Memorandum: it might be better to move paragraph 29 to Standard 17, since it relates more to the transparency of information than to the legal framework itself. Paragraph 32 may describe best practice throughout Europe, but it could run counter to the implementation of national insolvency laws in other parts of the world. In particular, a number of countries may have formal realization procedures to be applied in the case of bankruptcy; such procedures, although not disregarding the substantive rights of the settlement system to the collateral, could seriously impact the chances of immediate remedy.

#### **Standard 2 – Trade Confirmation and Settlement Matching**

We support the need to ensure timely trade confirmation and settlement matching. However, we would like to draw attention to the fact that the powers of clearing and settlement systems in this area are limited. CSDs and systemically important custodians/ICSDs may provide incentives for the market to perform matching in a timely fashion, but they cannot directly influence the behaviour of end investors, particularly when the latter are located overseas and use a network of global and sub-custodians. For this reason, we welcome the fact that Standard 2 is also addressed to market participants.

#### **Standard 3 – Settlement Cycles**

Shortening settlement cycles should be the overall goal of a fully integrated EU market. Nevertheless, we see no need for immediate action by regulators, since an alignment would entail immense costs and would require careful handling with respect to the risk of market failures that might arise. Furthermore, we recommend including target operating hours and access to central bank money in an overall concept at EU level.

#### **Standard 4 – Central Counterparties (CCPs)**

In consideration of the complexity of this standard, we recommend postponing its adoption until the CPSS/IOSCO standards for clearing houses currently under development have been finalized. These specific standards for CCPs will serve as a more clearly defined basis for harmonization in Europe and will take the particularities of central counterparties as a trading-related function into account.

#### **Standard 5 – Securities Lending**

We welcome the strengthening of centralized securities lending facilities via a specific risk reduction mechanism.

## **Standard 6 – Central Securities Depositories**

As explained above, CSDs that provide notary functions compete with other custody providers, which may even operate independently of CSDs. To ensure that the services provided by CSD are competitive, it is particularly important for smaller market participants that CSDs are also allowed to offer additional services, certainly by providing highest standards of risk mitigation. As a consequence, we feel that the wording in key element no. 4 and paragraph no. 74 should be amended to take this market reality into account. Therefore, we recommend using the phrase “manage risk” instead of “avoid risks”. Allowing CSDs to offer a range of services would ensure the consistency of the concept of functional regulation.

## **Standard 7 – Delivery Versus Payment (DVP)**

For the proper implementation of this standard it is important to clarify the term “delivery versus payment”, and in particular the different degrees of DVP, especially in respect to cross-border settlement and in line with Standard 8. Clearstream has very positive experience by operation DVP cross-border links with other CSDs and is open to expand that service in line with the further development of the “New German Settlement Model” (see Standard 10 as well).

## **Standard 8 – Timing of Settlement Finality**

Our opinion is that this standard should also apply to central banks if the aim is to achieve real-time finality.

## **Standard 9 – Risk Controls in Systemically Important Systems**

No comments.

## **Standard 10 – Cash Settlement Assets**

We share the view that central bank money settlement offers advantages. However, a system that is workable on a cross-border basis must include national central banks as addresses. Unless the rules of the Eurosystem are changed and full multi-currency interoperability with non-European central banks is achieved, it should be recognized that commercial bank money will remain a viable and essential means of settling cross-border transactions.

In this respect, we also believe that it is essential that the ESCB recognize the different methods for transferring central bank money claims between settlement systems, during both the day and the night, irrespective of the functionality of Target 2. We believe that the Operated Account Model, the Mandated Payment Model and the remote Guarantee Model are valid and, to varying degrees, pragmatic proposals for achieving this goal. In particular, the ESCB should accommodate, to the extent possible, the co-existence of such solutions.

### **Standard 11 – Operational Reliability**

We strongly support high standards of operational reliability for all systemically important systems as a core requirement for ensuring market stability.

### **Standard 12 – Protection of Customers’ Securities**

Protection of customer’s securities is one of Clearstream’s main objectives. Therefore, we support this standard.

### **Standard 13 – Governance**

We explicitly welcome this standard and, in particular, the fact that it does not prescribe a specific organizational model for clearing and settlement service providers, or a specific structure for post-trade markets.

### **Standard 14 – Access**

Open access to dominant systems is already a requirement under EU competition law. When addressing this by means of a specific regulation, it is important that consistency is ensured: both the Investment Services Directive in the version following its first reading and EU competition law recognize the fact that a refusal to provide access could be based on “legitimate commercial grounds”. A similar caveat should be added to the CESR/ECB standards.

### **Standard 15 – Efficiency**

We strongly support the aim to increase market efficiency. But only in combination with other standards, in particular Standard 16, the goal of Standard 15 can be reached.

### **Standard 16 – Communication Procedures, Messaging Standards and Straight-Through Processing**

In order to ensure competition, it is necessary to introduce standards to facilitate the efficient exchange of data between computer systems and to underpin the drive towards straight-through processing, which allows the entire end-to-end or customer-to-customer transaction flow to be computerized. To this extent, the use of a common set of standards is essential in facilitating the integration on a level playing field of national post-trade structures and international markets.

Deutsche Börse Group sees Straight Through Processing as one of our major objectives. Together with market participants we are discussing on a regular basis how we can increase our STP even further. An independent STP-Analyse (performed by SWIFT in the first quarter of this year) confirmed that we are already with respect to STP very well positioned and a leader of the industry.

**Standard 17 – Transparency**

No comments.

**Standard 18 – Regulation, Supervision and Oversight**

We would ask for the goal of streamlining supervision at a national and EU level to be added.

**Standard 19 – Risks in Cross-System Links**

We cannot see the need for a specific standard on cross-system links, since the same rules as for domestic participations should apply (given that the standards apply to similar functions).

Frankfurt, October 2003



## Appendix

### Scope of Regulation and Application of the Functional Approach to Specific Standards

	Systemically Important Systems <sup>5</sup>		Agent Banks
	CSDs	Systemically Important Custodians / ICSDs <sup>6</sup>	
<b>Definition / Description</b>	Safe custody of securities (custody services, interest and dividend payments, capital changes) for institutional customers, banks and financial intermediaries in physical or technical vaults and in direct possession, consequently known as central securities depositories or final custodians. All services can be granted on the basis of an effective power of agency. Securities are not moved for clearing and settlement; rather, they remain with the CSD (physically or electronically). The securities are booked at the CSD as the end custodian with which both counterparties have a direct account relationship (notary function). The CSDs maintain these direct accounts.	Proposed definition using the following cumulative elements:  (1) the provision of multi-market links (i.e. a certain number of linked markets)  (2) a separate product offering for third parties  (3) (potentially) the ratio of internally settled transactions to externally settled transactions for different clients groups	Single market custodians
<b>Trade Confirmation and Settlement Matching (Standard 2)</b>	+	+	+
<b>Settlement Cycles (Standard 3)</b>	+	+	-

<sup>5</sup> The application of standards for CCPs should be postponed until the final approval of the CPSS/IOSCO Recommendations (for example, Standard 3 requires different treatment regarding risk management that is stipulated by standard 4).

<sup>6</sup> For the comparability of services between ICSDs and custodian banks, see the first Giovannini Report, Giovannini Group, Cross-Border Clearing and Settlement Arrangements in the European Union, November 2001, page 9: "Global custodians and ICSDs now have similar functions". ICSDs provide safe custody of securities (custody services, interest and dividend payments, capital changes) for institutional customers, banks and financial intermediaries; they have no physical or technical vaults and hence no direct possession of the securities, but they do have indirect (construed) possession. All services are performed via an account booking at the ICSD by mirroring the bookings of the final custodian (not necessarily a CSD – it could also be an agent bank or common depository), which has direct possession of the securities. Therefore, an account link to a final custodian for the purpose of mirroring the securities deposits is necessary. As no direct possession of the securities is involved, the ICSD is only an intermediate custodian. Indirect possession for the booking, clearing and settlement of securities is sufficient.

<b>Securities Lending (Standard 5)</b>	+	+	-
<b>Risk Controls (Standard 9)</b>	+	+ (But overlap with banking regulation)	-
<b>Operational Risk (Standard 11)</b>	+	+	-
<b>Access on Non-discriminatory Basis (Standard 14)</b>	+ (Competition rules require open access)		-
<b>Communication Procedures, Messaging Standards, STP (Standard 16)</b>	+	+	-
<b>Legal Framework and Transparency (Standards 1, 17)</b>	+	+	-