



6 November 2003

ESF's Contribution to the ESCB-CESR Consultation on 'Standards for Securities Clearing and Settlement Systems in the European Union' and on 'The Scope of Application of the ESCB-CESR Standards'

In response to the call for contributions to the ESCB-CESR Consultation on 'Standards for Securities Clearing and Settlement Systems in the European Union' and on 'The Scope of Application of the ESCB-CESR Standards' we set out our comments as follows:

ESF general comment

- The European Securities Forum, representing 23 of the largest market operators active in the European securities markets, welcomes the ESCB-CESR Report on Standards for Clearing and Settlement Systems in the European Union as *the harmonisation of the regulatory environment* is deemed an essential part of an overall integrated clearing and settlement environment in Europe.
- Beyond this, the active support of ESCB and CESR as highly respected institutions in favour of harmonising and integrating the post-trade environment in Europe – vis-à-vis authorities at national and at EU level – will be a significant influence factor.
- Given the global activities of the members of ESF, the *compatibility* of these standards with the globally applicable recommendations of CPSS/IOSCO is equally welcome and important. In particular, any extension of the CPSS/IOSCO recommendation must be fully justifiable within the context of that original exercise, to avoid the proliferation of inconsistent standards.

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- As outlined in ESF's Contribution to the Joint CESR/ECB Consultation on Clearing and Settlement of May 2002, we fully concur with the *functional approach*. We are confident that ESCB-CESR would agree that such a functional approach necessarily calls for a clear definition of the function(s) intended to be addressed by the Standards.
- Such clarity may, however, be lacking, as exemplified by the absence of any underlying functional basis for including custodians within the Standards. The essential role of a custodian is to provide safekeeping and asset servicing functions. These are indisputably not clearing and settlement functions covered by the Standards. Nor do custodians operate the central securities depositories which provide such clearing and settlement functions.
- Certain financial institutions may perform settlement-like functions by transferring securities between two customer accounts at their respective "omnibus accounts" at a CSD. Such functions are performed by the financial institution qua financial institution, not qua custodian. It is, therefore, unsound to identify custodians as a class of organisation that may potentially be subject to the Standards.
- If, as ESF believes, it is ESCB-CESR's objective that the Standards should apply to financial institutions that perform the above described function to a significant extent, ESCB-CESR should so articulate unambiguously, so that the impacted financial institutions and national authorities can properly address all relevant issues. For even when a financial institution provides such services, the central securities depositories remain the ultimate book of record.
- An immediate and appropriate consequence of such an articulation would be that most bank custodians would properly be excluded from the application of the Standards and would continue to be subject to all the risk management and highly sophisticated regulation which currently apply to them.
- ESF endorses the *objectives* of the standards, however, takes the view, as outlined in the specific comments, that partly they are not adequately reflected in the work of the ESCB-CESR Joint Working Group, taking into account the dual objective of reducing risk *and* cost.

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ESF specific comments

- **Standard 1: Legal framework**

The key element # 3: “The legal framework should demonstrate a high degree of legal assurance for each aspect of the clearing and settlement process” can be best achieved through a continuous process of harmonisation of securities laws in Europe. We therefore propose that the ESCB-CESR Joint Working Group actively supports the project of legal harmonisation (EU Securities Account Certainty project) as described in the Second Report of the Giovannini Group published in April 2003.

- **Standard 3: Settlement cycles**

This standard should serve to contribute to the removal of current fragmentation and vested (national) interests. However, we deem the planned follow-up work (item 22, p.7) unnecessary and a duplication of initiatives under way (Second Report of the Giovannini Group, Working Group 5 of ECSDA, Call for Action of ESF). We therefore propose that this inappropriate warning finger be removed.

- **Standard 14: Access**

In our view the described key elements do not go far enough to warrant fair and open access. We therefore encourage the ESCB-CESR Joint Working Group to actively support the removal of existing national restrictions as described in the Reports of the Giovannini Group (in particular barriers 2 and 9). Banks on the other hand should be able to apply commercial criteria as to whom they grant access. A possible abuse of a dominant market position by a custodian bank in this respect is in our view a matter for competition authorities and not for regulators as outlined in our comments regarding the scope of application.

- **Standard 18: Regulation, supervision and oversight**

In view of the much needed harmonisation of the regulatory environment in Europe as an essential part of an overall integrated clearing and settlement environment in Europe, we deem this to be ***the single most important standard***. In order to foster the harmonisation and integration of the regulatory environment within the European Union – for example by way of introducing the home passport principle for securities regulation – we propose that the ESCB-CESR Joint Working Group actively supports respective legislative actions on the part of EU authorities.

It is our position that the objectives 1, 2 and 8 of the standards can effectively only be achieved this way.

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- **Scope of Application of the ESCB-CESR Standards**

As outlined in our consultation contribution of May 2002, applying the functional approach requires “to include any entity providing clearing and settlement services” in the regulatory framework though in a differentiated way according to the services provided.

Representing major banks active in the European securities markets, ESF has the strongest interest in the safety, stability, efficiency and cost effectiveness of the clearing and settlement system in Europe. Against this background its members support risk reducing measures like CCPs.

However, in order to achieve objective 2 of the standards, i.e. to avoid duplication of regulatory burdens and undue cost, additional regulatory activities to which banks might be subject, should take place ***within the existing framework of banking regulatory and supervisory structures. Moreover, banks apply a comprehensive management of their risks irrespective of whether they relate to securities services or other banking activities;*** to require special risk mitigating measures (collateral) as provided for in Standard 9 is therefore deemed inadequate.

Finally, as was ESCB-CESR’s stated commitment we urge you to discuss the definition of systemically important providers at a hearing with the largest market participants. Subject to the points expressed in our General Comments above regarding the inclusion of custodians within the Standards, given the possibility that ‘custodians that have a dominant position in their market’ could be included in standards 13, 14, 15 and 17 – ***however, in our view this is a matter for competition authorities and not for regulators*** –, the definition of ‘dominant market position’ should be carefully reconsidered in this discussion.

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