JOINT WORK OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS IN THE FIELD OF CLEARING AND SETTLEMENT

A CALL FOR CONTRIBUTIONS FROM INTERESTED PARTIES

The collaboration project between the Committee of European Securities Regulators (CESR) and the European System of Central Banks (ESCB) (collectively the "Group") in the field of securities clearing and settlement was announced in a joint press release by the European Central Bank (ECB) and the CESR on 25 October 2001.

Issues for consideration
The issues listed below have been touched upon in the Group's discussions. As such, they do not represent an exhaustive list of topics to be examined, rather they are indicative of the breadth of issues for discussion and intend to serve merely as a starting point for future debate.

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1. Nature of the recommendations

1.1 What should be the legal nature of the recommendations and/or standards to be issued by the Group?

Answer: Recommendations. The legal framework should be harmonised by public authorities.

1.2 Are there issues for which a European legal instrument is deemed appropriate?

Answer: Harmonisation of the legal framework, e.g. in relation to taxation and custody and safekeeping.

1.3 Are there recommendations and standards that should be adopted by national law?

Answer: There are starting points (see 1.2 above), but as yet no concrete proposals.

2. Addressee

Who is the appropriate addressee of the possible standards or recommendations to be drawn up by the Group: the regulators, the systems, the operators or the users?

Answer: All of the above.

2.1 In such cases where standards and/or recommendations are addressed neither to regulators nor to legislators, what are the appropriate incentives for their implementation and compliance with them?

Answer: If the regulatory framework is increasingly harmonised in the different markets, the markets will see to the implementation of further standards.

3. Scope

3.1 Do you agree that the scope of the Group's work includes any entity providing clearing and settlement services or associated aspects and is not limited to any particular type of service provider?

Answer: Yes.

3.2 More specifically, do you agree that central securities depositories (CSDs), international central securities depositories (ICSDs), central counterparties (CCPs), custodians and registrars should be included?

Answer: Yes.

3.3 Do you think that some standards should apply on a differentiated basis to these parties given that the scope of their business is not directly comparable?

Answer: For parties playing similar roles in the securities transaction chain (e.g. central counterparties, international central securities depositories), the standards should apply uniformly.

3.4 Should standards apply to other parties? If so, which standards and to which parties?

Answer: Standards should be set along the securities chain. Each party playing a role in this chain should comply with the relevant standards.

3.5 With regard to custody and safekeeping services, what are the advantages or disadvantages of a distinction being drawn between custody services, on the one hand, and clearing and settlement on the other?

Answer: The setting of standards should be oriented to the possible roles in the securities chain. In this respect, the distinction made between clearing/settlement and custody and safekeeping is not particularly helpful.

3.6 Do particular considerations apply where custody and safekeeping services are provided by credit institutions or investment services firms?

Answer: Every party involved in this process should be treated equally. Differences may arise as a result of regulatory aspects.

3.7 With regard to the securities covered, do you agree that sovereign and private debt, equity and other securities, as well as depository certificates, receipts, derivatives, etc. should be included, or where would differentiation be necessary?

Answer: All securities should be included so that the standard does not have a limited scope of application.

3.8 Should some standards/recommendations be specifically addressed to cross-border transactions? If so, which ones?

Answer: If the rules and regulations of the different markets are harmonised, cross-border transactions will automatically become more efficient.

4. Objectives

4.1 The objectives of central banks and securities regulators in the field of securities clearing and settlement systems could be summarised as follows:

4.1.1 risk mitigation, including investor protection, for both the system and the users;

4.1.2 efficiency, including for cross-border activities;

4.1.3 creation of a level playing-field between participants and service providers, irrespective of their legal status or their geographical location;

4.1.4 promotion of integration of the EU securities markets infrastructure. Do you agree?

Answer: Yes.

4.2 Do you consider that these objectives are sufficient?

Answer: Insofar as 4.1.2 and 4.1.3 would involve the harmonisation of rules and regulations at a European level, there is no need for anything further to be added.

5. Access conditions

5.1 Are you aware of access conditions to specific service providers which could be considered discriminatory? If so, where do the main problems lie?

Answer: E.g. difficult and costly direct connection to national central securities depositories. The individual participant does not have the critical mass to be able to cover the wide range of different processes and systems in the various markets. To a certain extent, there are also access restrictions on foreign institutions. Access to clearing systems is especially problematical.

5.2 Do you consider that the present rules do/do not establish a level playing-field in this respect?

Answer: Large institutions with branches in different markets have a competitive advantage over institutions, which are only active nationally and need to go through agents in the local markets.

5.3 Do they relate to the access criteria of the system or to other conditions such as operational features? If so, which ones?

Answer: See 5.1 above.

6. Risks and weaknesses

6.1 What are the most relevant factors with regard to risks and weaknesses in terms of clearing and settlement of domestic and cross-border transactions (i.e. legal, settlement, custody and operational risks)?

Answer: Real delivery versus payment only exists within a system. In settlement between systems there is no real DVP. In the various markets, different practices are based on different frameworks. As there is no integration of the markets, liquidity management and collateralisation are particularly difficult. Generally speaking, too many participants are involved in the securities chain.

6.2 What kind of problems can different legal approaches create?

Answer: See 6.3.

6.3 When looking in particular at cross-border transactions, how does the existence of different jurisdictions and the involvement of several actors such as local agents, global custodians, foreign CSDs or ICSDs in the process of cross-border clearing and settlement affect the nature and magnitude of these risks?

Answer: Too many participants are necessary and there is insufficient transparency of a transaction's settlement status.

6.4 What would be the most appropriate manner of addressing these issues?

Answer: Harmonisation of the respective national rules and regulations. When this step has been taken, the market will itself harmonise systems and processes.

6.5 As far as custody activities are concerned, do you agree that the segregation of assets and the reconciliation of positions are the most crucial issues to be addressed?

Answer: Yes.

6.6. As far as settlement risk is concerned, do you agree that the definition and timing of finality (including the need for intraday settlement finality), delivery versus payment, access to central bank money as settlement assets for systemically important systems and conditions of use of central bank money versus commercial bank money are the most crucial issues to be addressed with regard to clearing and settlement of domestic transactions?

Answer: Yes.

6.7. What specific impact could these issues have on clearing and settlement of cross-border transactions?

Answer: Above all, they could result in an increase in risks, liquidity and the costs related to both these aspects.

6.8. As far as operational risks are concerned, what are the main factors to be considered?

Answer: Lack of automation/linkage. Lack of transparency of processes and of status at cut-off times when subsequent processes need to be initiated.

7. Settlement cycles

7.1 What are the arguments for and against harmonised and/or shorter settlement cycles?

Answer:
Pros: Cost reduction, faster handling of securities, optimisation of liquidity management, risk mitigation.
Cons: See 7.2.

7.2 It appears, for instance, that while a very short cycle could increase settlement default rates, a longer cycle could increase uncertainty and settlement risk.

Answer: Yes. High settlement default rates can be counteracted by market rules, straight-through processing or securities lending. The sequence should be:
1. Harmonisation
2. Automation
3. Shortening of settlement cycles.

7.3 Is there a need to adopt different settlement cycles for different securities, such as for equities and government debt instruments, etc.?

Answer: From a settlement standpoint, no.

8. Structural issues

8.1 The structure of the securities clearing and settlement industry in Europe has been hotly debated recently. An integrated market can be achieved via a number of routes, with concentration, interoperability and open access being the most obvious alternatives.

8.2 What are the arguments, if any, for a public policy intervention relating to: (i) centralised or decentralised structures for infrastructure and service providers; and (ii) the governance structure of infrastructure and service providers?

Answer: The harmonisation of a market cannot be predetermined by a sovereign entity. However, public authorities can support/promote market integration, in particular by harmonising legal frameworks and eliminating legal barriers.

8.3 Are custodians, CCPs, CSDs and ICSDs to be considered as commercial firms, driven by regular competition, or should they (or some categories of these entities) be considered as utilities whether or not they operate within a monopoly environment?

Answer: Custodians are per se commercial firms driven by competition. Furthermore, national central securities depositories and central banks will for the foreseeable future occupy a monopolistic position in the respective markets. A fragmentation of these structures would not be a good idea. However, monopolistic institutions should be owned by market participants. International central securities depositories should be fully viewed as competitive undertakings.

8.4 Does the same reasoning apply to the providers of trading services?

Answer: Trading service providers should operate in a market-oriented fashion.