MADRID STOCK EXCHANGE

COMMENTS AND SUGGESTIONS OF THE MADRID STOCK EXCHANGE ON THE "ISSUES PAPER" PRODUCED THE 15 MARCH 2002 FOR THE JOINT WORK OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS IN THE FIELD OF SECURITIES CLEARING AND SETTLEMENT

1. The scope of these comments

The Madrid Stock Exchange is the major financial centre for trading on securities in the Spanish Securities Market.

Among the different relevant aspects and phases related to the overall securities transactions, the current functions and legal responsibilities of the Madrid Stock Exchange are concentrated on the trading phase and presently do not involve any responsibility concerning the clearing and settlement of transactions.

Therefore, the following comments shall focus the consulted issues taking specially into consideration the needs and concerns of this trading phase and trying that every progress on the clearing and settlement phase fit properly the specific requirements of the previous trading phase of the concerned transactions.

Trying to bring some helpful contribution, the following comments will follow the same order according to which this Issues Paper identifies the different questions it collects.

2. The nature of the proposed recommendations. The joint work between the Committee of European Securities Regulators (CESR) and the European System of Central Banks (ESCB) in the field of securities clearing and settlement is a relevant part of the current general debate on the situation of the European Securities Market and on the improvements it requires.

The commented Paper explicitly recognises that there are other relevant initiatives on the course and, for instance, mentions the announced forthcoming European Commission communication on clearing and settlement issues. Other important initiative coming from this same source is the announced general revision of the Investment Services Directive, which apparently includes some of the issues connected to clearing and settlement.

This is to say that, in the very next times to come, we will face new stages and regulations focusing, among others related to the securities markets, the field of clearing and settlement.

Taking this overall context into consideration, the joint work of CESR and ESCB should be seen as a valuable opportunity to summarise which are the main facts that should be tackled whilst advancing in fitting the current European clearing and settlement regulation and procedures to the new needs and trends.

Therefore, the result of this joint work will be a useful buck of information to be surrendered to the European Commission in order to be considered in the course of the elaboration of the new instruments and regulation required in the field of clearing and settlement.

The precise moment to assess the best legal treatment applicable to this information will be once its content is known. Saying that in other words, there should not be a special interest in defining at this very first stage of the commented joint work" which will be the detailed legal way to instrument and put in place its main conclusions.

More concretely, once finalised this joint work, it will feasible to know which of its conclusions need eventually one or several European legal instruments or can be adopted through national laws or instruments.

3. The addressee of the recommendations. Consequently with what has been said in the previous section of these comments, the exact nature and extent of the addressees of the final recommendations will only be known in the course of its elaboration and no special stress should be put "a priori" in order to identify them.

4. The scope of the recommendations. As far as its subjective scope is concerned, the joint work of CESR and ESCB must include any entity providing clearing and settlement services and its associated aspects in the broadest sense of the word, including thus central securities depositories, international central securities depositories, central counterparties, custodians and registrars.

This broad scope should be encompassed with diversified standards applicable to the entities included in differentiated groups.

The leading idea to form and treat such groups is not a subjective but an objective one. The aim is to draw the same basic patterns of conduct applicable to each type of activity (the proposed level playing field) with the view of allowing a proper level of free and efficient competition among the involved parties.

Applied to an example explicitly mentioned in the Issues Paper, this orientation would lead to differentiate between custody and safekeeping activities, on the one hand, and clearing and settlement activities on the other.

Giving that the distinction relies on objective grounds, the patterns applicable to each kind of activity should not incorporate particular considerations coming from the fact that a concrete entity furnishes simultaneously several kind of activities. This is the case, for instance, of credit institutions and investments services firms providing at the same time custody and safekeeping services and clearing and settlement activities.

In such kind of cases, it should be naturally viewed that each of the sections and departments of a same entity receive differentiated regulations and apply diversified procedures as long as required by the type of activity they carry on.

Moving to the objective scope of the recommendations that the joint work of CESR and ESCB must elaborate, it should include any kind of securities traded in organised markets.

As pointed out concerning the subjective scope, this broad objective scope is compatible with the existence and applicability of differentiated rules to each kind of securities and also to special ways of trading them, for example through cross-border transactions.

5. The objectives of the recommendations. We share the first three objectives pointed out in the Issues Paper.

As of the fourth one, it misses some more precision in the exact meaning of the proposed "integration of the EU securities markets infrastructure".

Applied to this "infrastructure", the word "integration" seems to imply an institutional sense, pointing out to some kind of corporate general integration between the different bodies currently involved in clearing and settlement activities all across Europe.

We feel that this precise sense of "integration" is neither the most urgent nor the advisable approach to reach a substantial enhancement in how clearing and settlement services are currently provided in European markets.

As a matter of fact, we favour that the bulk of the integration in the field of securities clearing and settlement systems must be put in how they work and provide to all participants with an adequate environment for the quick, cheap, efficient and secure final fulfilment of their securities transactions.

In other words, the attention must be focused towards the day-to-day functioning of the clearing and settlement activities in each European national system and in the international structures of the like.

6. The access conditions. At the current stage of investigation and available information, we do not identify relevant discriminations in access conditions to specific service providers.

Notwithstanding this statement, a careful attention must be paid to access to cash settlement and to registrars systems, especially as far as cross-border transactions and businesses from entities subject to different jurisdictions are concerned.

7. Risks and weaknesses. Starting these comments with the legal risks, the existence of different jurisdictions imply that it is not always easy to perceive which is the specific legal position and functions of each entity. This is especially clear coming from the fact that not every concerned jurisdiction conceive and define such entities in the same way.

Therefore, rather than the mere existence of different jurisdictions, the source of some eventual problems is twofold. On the one hand, the accurate perception of the role that every entity performs in its home jurisdiction and in the other ones where it carries on businesses. And, on the other hand, the consequences of the inter-relation among every entity involved in a concrete transaction.

To tackle adequately such kind of situation, the proper response should also be twofold. On the one hand, a very relevant role must be recognised to the open and widespread knowledge of the precise activities and legal responsibilities of each entity. Additionally, a

flexible adaptation of each home jurisdiction is required in order to reflect this diversity of entities who take part in the securities trading, clearing and settlement.

Moving now to custody activities, we share the view that the segregation of assets and the reconciliation of positions are some of the most crucial issues.

Considering this segregation of assets, a very detailed approach is advisable in order to precise every of its consequences. To that end, a specific attention must be paid to the operational procedures applicable to that segregation from the point of view of the investors, the owners of the concerned securities and the entities who take part in the affected transactions. A cheap and efficient procedure that enables the affected parties to quickly segregate their securities is the aim in that field. To achieve that goal, a precise definition of the legal privileges and provisions and of the applicable administrative or judicial procedures to warrant this segregation will be required.

Turning the attention to settlement risks, the joint reflection of CESR and ESCB will benefit from the extremely important protection that the Settlement Finality Directive (Parliament and Council Directive 98/26/CE, of 19 May) brings to the European securities markets.

This European Directive is a very explicit example of what has been pointed out regarding the most adequate treatment for legal risks involved in clearing and settlement. In fact, that Directive imposes to every European securities market the obligation to fix and make public the very precise moment from when every transaction included in its clearing and settlement system will benefit from a legal finality.

This approach respects thus the diversity among the different European markets in defining its own rulings but, at the same time, serves the need of a public knowledge of their own and specific rules so every interested party can adjust its decisions to the specificity of the market where it wants to operate.

The result balances adequately the necessary flexibility while dealing with different realities –as the European securities markets are- and the offering of a harmonised treatment of such a relevant issue as the settlement finality is.

Other relevant issue facing the settlement risks is the respective use of central bank facilities versus commercial banks ones with regard to clearing and settlement of transactions.

Once again, better than a uniform response is solving this point through a clear and public known regime that takes into account the diversity that may exist among different markets, securities and types of transactions.

The last point to be considered relates to operational risks.

At that respect, the highest priority must be a proper identification of the critical and potentially harmful stages of the whole clearing and settlement process in order to assure the allotment of the necessary human and technical resources to supervise them.

8. The settlement cycles. Our specific comment on that point is that the highest priority is to harmonise, around T + 3, as far as possible and without prejudice of the specialities required by some markets or securities, the different settlement cycles that currently exist in the securities markets.

At the same time, the joint work of CESR and ESCB should clearly stress the risks that may arise if the different European markets engage in a against-.the- clock race to reduce their settlement cycles as an *per se* desirable and no limited aim.

As a matter of fact, the Issues Paper already points out that a very short settlement cycle could increase settlement defaults.

Additionally, this issue must not only be treated from the settlement phase of the securities transactions and thinking only about the improvements that may be introduced concerning in that phase. Given that some of those changes may also have relevant consequences on the trading phase of the overall securities transactions, we favour that a general reflection on that side be included in the joint work of CESR and ESCB.

A last factor that also favour to widen the analysis of the settlement cycles is the broad subjective scope of the joint work of CESR and ESCB, already marked in previous section 4 of these comments. Remembering now that this joint work will affect, for instance, custodians and registrars, the eventual consequences that a shorter settlement cycle in a concrete type of securities may have for their activities and responsibilities must also be carefully assessed.

9. The structural issues. As already pointed out in previous section 5 of these comments, the idea of the “integration” of the European securities markets admits several meanings.

Some of the wording used in section 2.8 of the Issues Paper seems to suggest that it is focusing this integration in the structural sense of the term, that leads towards some kind of institutional uniform model for the securities clearing and settlement industry all across Europe.

We feel that this is not the orientation that must be given the highest priority.

Instead of that, we favour the approach that emphasises the harmonisation of the key issues of several potentially different clearing and settlement systems and providers. In fact, the commented Paper collects some of them, as can be the cases of access conditions, settlement cycles, settlement finality and the like.

Such work of harmonisation must be of course encouraged and helped through the necessary public intervention.

But, on the contrary, this public stimulus should not try to impose or promote a concrete corporate or institutional model for every clearing and settlement system, admitting only, for instance, commercially orientated structures or public utilities.

To that respect, it must be noted that behind each of those systems lie considerably different legal orientations and traditions. It must also be noted that there are potentially different ways to articulate and solve the questions posed by the organisation of adequate structures for trading securities.

Some of those orientations and solutions are national-rooted while others have been created by supranational structures. In any case, most of them try to serve as best as possible and to bring efficient responses to the needs detected in the securities trading.

Taking into account such a diverse panorama, it seems worthy not to challenge at the first stage all these structures but concentrate the priority in the way they work, trying to incorporate the necessary harmonisation and enhancements.

Madrid, 6 May 2002