Investment Management Association

Wim Moeliker (CESR) at secretariat@europefesco.org
Elias Kazarian (ESCB) at ecb.secretariat@ecb.int

30 October 2003

Dear Sirs

CESR-ESCB Standards for Securities Clearing and Settlement Systems in the EU

The IMA is pleased to have the opportunity to comment on the CESR-ESCB consultation paper on standards for securities clearing and settlement systems in the EU. The IMA represents the UK-based investment management industry. Our members include independent fund managers, the asset management arms of banks, life insurers and investment banks, and occupational pension scheme managers. They are responsible for the management of over £2 trillion of funds (based in the UK, Europe and elsewhere), including authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our members represent 99% of funds under management in UK-authorised investment funds (i.e. unit trusts and open-ended investment companies).

In managing clients' assets, IMA members are active participants in the securities markets. Though as investment managers they do not act as principal and are not the beneficial or legal owners of the securities they trade, they have fiduciary responsibilities to their clients and are involved in the settlement process. Our members therefore have a strong interest in the overall infrastructure of the securities markets in which they operate.

The IMA welcomes the ESCB-CESR efforts to enhance the safety and efficiency of securities clearing and settlement in the EU. However, our members have a number of concerns in relation to the scope and application of the standards which will have both a direct and an indirect impact on investment managers.

Direct impact on investment managers

While the standards primarily address the activities of central counterparties and central securities depositories, at least two of the standards – standard 2 and standard 16 - will have a direct impact on investment managers. We are concerned that it is unrealistic to expect investment managers to meet these standards in every circumstance and are therefore concerned about the potential costs associated with the standards.

65 Kingsway London WC2B 6TD
Tel:+44(0)20 7831 0898 Fax:+44(0)20 7831 9975
www.investmentuk.org

Standard 2 would require institutional investors to confirm trades as soon as possible after trade execution and no later than t+0. According to our members, about 90% of trades (at the block level) are confirmed at t+0. However, there are a number of reasons why it is not always possible to do so, and why that figure is even lower for trades at the allocated level. There are currently many ways to confirm trades - Omgeo, FIX, SWIFT, Telex, fax. For smaller operations which may tend to rely on fax and manual processing, meeting the standard to confirm trades no later than t+0 could prove very difficult. Moreover, in some markets, investment managers may not have a choice in the broker they do business with and therefore have little or no say in how they confirm trades. The investment manager is obligated to use the means the broker accepts, which may make it impossible to confirm trades at t+0. For trades executed late in the day, the ability to confirm these transactions at t+0 will also depend on how late the broker stays in the office and what is meant by t+0 (close of trading or close of business). For trades executed in one part of globe and settled in another, timing differences could cause additional delays in confirmation. In short, the ability to confirm trades no later than t+0 requires a joint commitment of the parties involved – both investment manager and broker – and may not in any event be achievable at all times in all cases. It is also important for the standard to make clear whether it relates to block matching or confirmation of allocated trades.

Similarly, standard 16 calls for market participants to support and use international communication protocols and standard messaging. Though IMA members welcome the move away from proprietary systems over time, the decision to use international communication protocols and standard messaging is not always at the discretion of the investment manager. For example, the custodian – which is selected by the client and not by the investment manager – may not use SWIFT or some of the standard protocols. Again, meeting this standard will require a joint commitment on the part of all the parties involved and, even then, may be difficult and costly to achieve in the short-term.

Application to custodians

As outlined in the consultation paper, the CESR-ESCB group is proposing to extend some of the standards to major custodians that operate systemically important systems. Our members have a number of concerns in relation to this. We believe that the proposals to extend the application of the standards to custodians fail to take into sufficient account a key fact – that such entities are generally banks which are already regulated and subject to prudential and other requirements designed to address the risks associated with their business. As a result, the application of the standards could result in unnecessary and duplicative regulation. This will invariably raise the costs of doing business which will be passed on to institutional investors who are among the major users of such custodian banks.

That said, our members recognise that over the medium-term the application of some, though not all, of the standards could reduce costs by increasing the efficiency of the clearing and settlement process. As noted above, some of the standards require the joint commitment of the different parties involved in the process. For example, over the medium term, there may be real benefits of STP, standardised messaging and the use of international communication protocols. On the other hand, we do not believe, for example, that standard 9 should require custodian banks to be regulated in the same manner as CSDs since custodian banks, unlike CSDs, are well-capitalised and in the business of extending credit, for which they have extensive procedures and controls.

Overall, we believe there needs to be a greater emphasis on the costs of implementing the standards for all the parties involved and an effort to measure the risks relative to those costs in order to prioritise the standards. For example, DVP may be critical, whereas moving towards even shorter settlement cycles, while desirable, may not be crucial to the safety and soundness of the system. Similarly, as noted above, trade confirmation no later than t+0 for investment managers as an important means of allowing for shorter settlement cycles may be a standard to aspire towards, but may be difficult and costly to achieve across the board, particularly for small fund managers and custodians.

Finally, we believe that the proposals do not adequately recognise the inter-relationship between the different standards and the impact that inter-relationship has on the overall risks and costs. For example, shorter settlement cycles need to be looked at in conjunction with central counterparty services.

We hope these comments are helpful. Should you have any questions or require further clarification on any of the points above, please do not hesitate to contact me.

Yours sincerely,

Ilene Hersher
Adviser, EU Legislation