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Comments by the Federation of European Securities Exchanges (FESE) on the CESR-ECB Consultative Report:
Standards for Securities Clearing and Settlement Systems in the European Union

A. Introduction

The Federation of European Securities Exchanges combining all cash equity markets, derivative Exchanges and other regulated financial markets as well as clearing houses in the EU, Switzerland, Iceland and Norway takes with pleasure the opportunity to comment on the consultation papers that the ECB/CESR Working Party (CESR 03/247) has put out for comments.

The comments below have the support of the entire FESE Membership and include comments by the CCP-based clearing houses that jointly form EACH, the European Association of Clearing Houses. As CESR and the ECB will be aware from earlier contacts and as is more fully described on the EACH Website, EACH is a group of clearing and risk management specialists. Most of the central counterparty clearing houses at which the specialists work are divisions or subsidiaries of European Stock Exchanges. Reflecting those links, EACH affiliated to FESE in 2001 and three independent clearing houses jointed FESE as a result of the affiliation. The technical comments of the EACH Group relating to issues of specific importance to CCP-based clearing houses will be sent to you separately.

We are indeed pleased to see the express reference to EACH's Standards of Risk Management Controls used by Central Counterparty Clearing Houses. As the Chairman of EACH has communicated to you, that group of experts is currently continuing its work on Standards for CCPs (beyond risk control) and on a paper defining CCP functions in the wider context of clearing and settlement. Beyond this conceptual work, EACH and its members will of course continue to take an active part in the discussion and look forward to involvement in the further work on Central Counterparty Standards.

Reference to other documents

As CESR and the ECB are well aware, the international discussion on clearing and settlement with an emphasis on cross-border EU business is not short of reports, studies, papers and proposals. We may refer to the earlier communication by the Commission to which both FESE and EACH commented as well (EACH and FESE letters of November 2002). We may also refer to the G30 Report which although of global focus has its applicability to the EU discussion. We finally refer to the own-initiative report by Mr. Andria MEP as approved by the European Parliament.

We notice the reference to the Giovannini Group's two reports. We may refer also to the comments by ECSDA, the European Central Securities Depositories Association. Furthermore, we make explicit reference to all comments submitted by individual FESE Members, either through their central offices or through their business units and affiliated companies engaged in clearing and settlement activities.

Clearing and Settlement in the context of the FSAP

The current discussions on the renewal of the Investment Services Directive as being held now in the European Parliament and in the Council also contain a number of important issues relating to clearing and settlement.

FESE and its Members would like to emphasise in the very first place that there should be a great degree of consistency between these various proposals and discussions, especially as more than one of them may lead to binding legislative regulatory and policy proposals.

With reference to the FESCO-drafted Standards for Regulated Markets, we would like to point out that any legislative or regulatory approach to clearing and settlement should take into account that technology and competition are currently the driving forces in the development of domestic as well as of cross-border clearing and settlement systems and approaches. Therefore, is it of the greatest possible importance – not to say it is crucial – that any legislation and regulation take into account and builds upon the flexibility that remains necessary.

EU-level legislation is as we know the product of a lengthy – and fortunately since Lamfalussy very open – consultative process, but it is also a product that in the future can be changed only with the greatest possible difficulty and dare we add delay. This again, is separate argument to plead for flexibility. Flexibility we would also like to stress is not in contrast to legal clarity, which especially in clearing and settlement is a crucial element for all participants.

<u>Clearing and Settlement and the regulatory scene</u>

In view of the above, we would like to repeat to ECB and CESR that these issues will have to be taken further into account when elaborating and finalising the CESR-ECB standards. We do not object to developing these standards further and therefore we do accept the regulators in Europe move from the phase of non-binding recommendations to binding standards.

We note however that under the current institutional and legal set-up, such standards will have to be implemented by all market participants and by the regulators within their national frameworks and on the basis of existing national formal and substantive legislation and regulation.

B. General comments

Before commenting on the individual 19 proposals for standards, we would like to make a few further general points:

The CESR-ECB proposals relating to the <u>scope of application the standards</u> will need further discussion and elaboration. Read jointly with the paragraphs on the objectives of the standards, we do feel that occasionally the <u>inner logic and consistency</u> leaves to be desired. By way of illustration, we believe that the standards partially are based on systemic risk and contagion issues and partially – and not always clearly distinguished – on considerations of efficiency and effectiveness, of investor protection (especially of the retail investor), of rights of access, and on prudential and other systems requirements etc.

Especially in the area of applicability or scope, we believe that all standards will have to be reviewed carefully, so as not to omit institutions that should be brought under certain standards and to delete institutions that upon second consideration should not bear the applicability. Overall, it is a functional approach that provides the best chance to address the right targets and their risks with the appropriate set of standards. We recall and support the comment made by Mr. Wymeersch at the hearing in Paris that existing market structures should not be meddled with in the absence of stringent necessity.

Also we do feel that especially in the area of application within individual jurisdictions, an additional complexity has to be brought in the scope of the rules. Again as an illustration, is “systemically important” a relevant criterion only at the EU level or is it of relevance as well within a specific individual jurisdictions? A systemically important institution within one of our smaller economies would upon failure endanger the functioning of that economy, without however having much of an impact in terms of contagion or systemic risk to the wider EU community. This would be different for instance in a jurisdiction like Germany, France or the UK. In addition, there is the criterion of linkage closely bound to the contagion criterion that should be looked at further but that we do believe is an important one in view of the increasing importance of cross-border securities business.

The papers propose to focus on bond markets (public bonds and corporate bonds), equities and derivatives. It is unclear whether derivatives on commodities like traded on some of our Members' specialised markets fall under this description. We underline that commodities markets too have important linkages with cash equity and financial derivatives markets.

Monitoring ongoing developments and enforcement are two areas of consistent concern for Exchanges and related institutions. From the text of the consultation paper, it is however not clear to us, whether such processes including the assessments of methodology (as among others practiced by the IMF) are going to be a matter for public disclosure in the CESR-ECB proposals or only disclosure between the regulator and the assessed institution. We would advocate a relatively high degree of publicity in this context.

We miss in the proposals a clear reference to the need to avoid duplication and double regulation.

Finally, we believe that passporting of clearing and settlement services in the EU, and beyond on the basis of objective requirements and criteria, should be part of the total package. We refer to the discussions about the ISD in this respect.

With reference to the objectives of the standards, we believe there is an over-arching standard or goal that has not been mentioned and that is the establishment of an integrated set of securities markets and appropriate, sound, cheap, safe and effective and efficient clearing and settlement systems. Objectives 1 to 8 indeed flow from that over-arching goal. We also believe that more attention should be paid to suggestions of liberty of Member States to deviate from such standards in individual circumstances. We recognise that there may be arguments for that but at the same time we stress the need for a level-playing field.

FESE Members agree that mutual recognition is desirable. It is equally true that it is not clear how regulators would accept such very general "Standards" as the basis for mutual recognition. The answer may appear to be in the proposed three-level approach consisting of

- the CESR-ECB Standards;
- a "national" evaluation whether those standards are met; and
- a "supra-national" evaluation exercise to reinforce mutual confidence.

This approach could and should work; one of the crucial success factors will be, as so often, that national regulators and Central Banks are prepared to adopt and apply a truly cross-border single-market mindset. Moreover, we feel that the evaluation method is "work in hand" and the review process is not elaborated. We would welcome a few more comments by CESR-ECB on this issue.

In this context, some FESE Members argue that, if the CESR-ECB Standards are in fact intended as the basis for mutual recognition, their width of focus should be reviewed and emphasis should chiefly be given to core prudential capital and risk-related issues while topics like market efficiency etc. should receive less emphasis.

On harmonisation of settlement cycles, we believe they should not be forced upon the clients of Exchanges or of clearing and settlement service providers. We therefore would suggest that the first proposals for further work be indeed undertaken, a review and identification of costs and benefits, but that the recommendation about harmonisation should not be top-priority and should not be a given conclusion already at this time. With this argumentation we follow up to our contributions to the work of the Giovannini Group and we see ourselves in the company of, among others, the European Banking Federation.

Before moving to comments on individual standards in the **annex** to this letter, we would like to note finally that the FESE Membership may return to the issue of the legal framework of the CESR-ECB proposals against the background of any forthcoming Commission communications and/or legislative proposals; we may wish to write anew to CESR and the ECB about such issues at a later stage. We would with what we wrote above also believe that CESR-ECB should consider a second round of discussion and consultation about the proposed standards after having reflected on the submissions received and having implemented any suggestions and proposals in such submissions as found favour with CESR and the ECB.

One of the other strategic issues that the FESE Membership would wish to consider further is competitive aspects between the EU services providers and the US American competition especially in view of the extraterritoriality that so often is part of US legislation.

The Federation, its Members and its Secretariat as well as the CCP experts forming EACH continue to be available for any further discussion on these issues and are looking forward towards good co-operation.

Yours sincerely,

Paul Arlman
Secretary General