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GROUPEMENT EUROPEEN DES CAISSES D'EPARGNE
E U R O P Ä I S C H E   S P A R K A S S E N V E R E I N I G U N G

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Position Paper

of the

European Savings Banks Group

on the

ESCB–CESR Draft Standards[1] for Clearing and Settlement Systems in the European Union

[1] May 2004 Version

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1. Introduction

The European Savings Banks Group (ESBG) welcomes the opportunity to comment on the ESCB–CESR Draft Standards for Clearing and Settlement Systems in the European Union, published in May 2004, and would like to express its appreciation of the fact that, at the Hearing organised on 25 May, ESCB–CESR decided to open a comment period until 21 June 2004.

Established in 1963 and based in Brussels, the European Savings Banks Group represents the needs and interests of its members and generates, facilitates and supports the management of cross-border banking projects. ESBG represents 24 members from 24 pan-European countries, comprising almost 1,000 individual savings and retail banks, operating 65,000 branches and employing 757,000 people. At the start of 2003, total assets of ESBG members amounted to EUR 4,355bn and total non-bank loans to EUR 2,195bn. ESBG members are typically savings and retail banks with a customer-oriented, socially responsible approach and a market focus of individuals, households, SMEs and local authorities.

2. General Remarks

In its response to the first version of the Standards[2] the ESBG expressed some serious concerns about the functional approach, the proposed scope and the impact of some of the Standards. The ESBG is pleased to note that many of the concerns expressed by itself and other parties during the first round of Consultation have been taken into consideration in the second draft of the Standards, but still has some comments on these issues as outlined below.

2. 1. The Scope of the Standards

The ESBG welcomes the fact that the ESCB–CESR has dropped its original proposal of applying arbitrary thresholds to defining what might constitute a “custodian operating a systemically important system” and has also dropped the notion of “custodians with a dominant position in the market” from the Standards.

The criterion advanced in Par. 14 of the latest version of the Standards, that custodians that have clearing and settlement activities comparable to those of national CSDs in terms of volume and value could be described as custodians operating systemically important systems, is a much better option than the original proposal of national and European thresholds. The new proposal to leave the assessment of which custodian banks may fall under this category up to national regulators and overseers has certain pragmatic advantages. It does however open up the possibility of diverging national interpretations of this concept, which would impact negatively on efforts to achieve the objective of creating a level playing field for the providers of clearing and settlement services in Europe. How this criterion can or will be interpreted for custodian banks that operate in more than one European country is not clear either.

It is noted that Standard 18 stipulates that central banks, securities regulators and banking supervisors should cooperate with one another both nationally and cross-border. This Standard also covers the cases of conglomerates, subsidiaries and recognises the “European” model of home country control for entities that are active in several EU countries. The ESBG

[2] (DOC 795/03)

very much welcomes this Standard and agrees that it should go a long way towards achieving cross–border prudential supervision in Europe. Nonetheless, in the light of the concern of diverging national interpretations expressed above and, in the belief that prevention is better than cure, the ESBG recommends strongly that ESCB–CESR delay the implementation of the final version of the Standards until at least such time as it has developed the assessment methodology to ensure comprehensive, consistent and continued compliance with the Standards as mentioned in Par.26. Further remarks on this issue are made under Point 2.3.

The ESBG has also noted that a number of the Standards (1,3,4,5,10,12,15&17) are now addressed to parties, that were not covered in the past, such as relevant public authorities, custodian banks, settlement agent banks, regulated financial institutions acting as cash settlement banks, banks, investment firms and market participants. The ESBG does not have a major issue with the enlargement of the scope of the Standards to these new addressees, with the exception of Standards 15 and 17 as indicated under Point 3 below. Furthermore it particularly welcomes the inclusion of the relevant public authorities in a number of the Standards. For the sake of clarity and uniform interpretation, it is however essential that the different terms used to describe banks or financial institutions in the Standards are defined very precisely in the Glossary that is now attached to the Standards.

2.2. The Functional Approach

The ESBG welcomes the fact that the ESCB–CESR has taken on board many of the comments made on the functional approach in the first consultation and has now reoriented its functional approach to recognise the differences caused by the fact that certain functions are currently subject to different regulation depending on the institutional status of the entity that performs them (Par.7). In particular it welcomes the explicit recognition of the fact that custodian banks are subject to EU banking regulation in Standard 9.

2.3. Timing of the Implementation of the Standards

The ESBG is concerned about the timing of the application of the Standards, particularly in the light of the Clearing and Settlement Directive announced in the Commission Communication. As outlined during the first Consultation, the ESBG maintains that the Standards effectively constitute “soft” law. Thus the implementation of these Standards on the market before the “hard” law constituted by the EU Directive, which has now been formally announced, is not appropriate. The topic of clearing and settlement has become highly political since the ESCB-CESR started work on the Standards and accordingly it would be preferable if these Standards were introduced with a specific political mandate given under the usual EU democratic legislative process.

The implementation of the Standards before the establishment of a Level 1 Framework constituted by the proposed EU Directive is, essentially, putting the cart before the horse, as intimated in the recent Commission Communication. The latter states specifically that “the ESCB–CESR Standards could form the basis of any Level 2 implementing measures to be developed in accordance with the enabling provisions of the EU Directive”.

The Communication and indeed the Introduction to the Standards themselves (Par.10) recognise the fact that the Standards do not replace a proper legislative framework, with the corresponding negative impact on legal certainty in the industry. The possibility of diverging national assessment frameworks and regulation in the absence of such an EU regulatory framework will generate level playing field distortions.

In the ESBG opinion, the ESCB–CESR Standards should therefore remain as Recommendations and a strong benchmark of European best practice for the present. Accordingly, the formal implementation of the Standards at a national and European level should be put on hold until such time as the EU Directive has been adopted. Subsequently the Standards can be taken as a basis for the implementing measures under Levels 2 & 3 of the Lamfalussy procedure.

In the worst case scenario, the ESBG believes that ESCB–CESR should delay the implementation of the final version of the Standards until at least such time as it has developed its planned assessment methodology, as mentioned under Point 2.1. above. Work on the latter will presumably provide the ESCB–CESR joint working group with the possibility to align their views on the precise interpretation of each element of the individual Standards and on criteria for the definition of what constitutes a systemically important system at a national and/or European level and thus minimise the risk of distorting the desired level playing field at a European level. It will also provide them with the possibility of a prior peer review of existing or emerging national or European cases of abuse of a dominant position in a particular market by a CSD or custodian bank, by itself or in collaboration with others as outlined in Par.8.

2.4. Interpretation of the Standards

The ESBG would like to reiterate the point made in the first Consultation that the three levels or layers of detail in the Standards, i.e. Standard, Key Elements and Explanatory Memorandum lead to a certain amount of confusion firstly, as to which level(s) of the Standard is/are binding per se and secondly, which element(s) of the standards apply to the various addressees.

At the first open Hearing in October 2003, one of the Co–Chairs of the ESCB-CESR joint working group, stated in response to a question on this topic, that the first two levels formed an integral part of the standards and that the explanatory memorandum served to clarify the intentions of the Regulators, but was not binding as such. At the Second Hearing on 25 May 2004, one of the Co–Chairs of the ESCB-CESR joint working group, stated in response to questions on the applicability of a number of the Standards, that all of the elements of a standard did not apply indiscriminately to all of the addressees.

Accordingly, the ESBG requests that the Introduction to the final version of the Standards contains a specific statement concerning the binding nature of the abovementioned three levels in the Standards. Secondly, it supports the request made at the Second Hearing to introduce a matrix into the final version of the Standards, which would outline clearly for all the individual Standards, which element (s) were applicable to which addressee(s). The text of the Key Elements and Explanatory Memorandum of each Standard should be more specific on this point also.

3. Specific Remarks on the Standards

Standard 1 Legal Framework

It would be useful to define the term “settlement agent bank” in the Glossary attached to the Standards.

Standard 9: Credit and Liquidity Risk Controls

The ESBG appreciates the fact that the ESCB–CESR have taken on board many of the comments made by market participants during the first Consultation and that they have amended the Standard considerably. It believes that the new version constitutes a fair compromise between the positions of infrastructures and intermediaries, subject to the proviso made in the above general remarks about potential market distortions caused by varying national interpretations of what constitutes a custodian operating a systemically important system.

Standard 13: Governance

As noted in Point 2.1. above, the ESBG welcomes the fact that “custodians with a dominant position in a particular market” have been removed from the scope of the Standard. It believes that specific governance rules for entities that carry out clearing and settlement business are only justified if these entities enjoy a monopoly type position, as for example, is the case of CSDs for the final custody of securities.

Standard 15: Efficiency

This Standard is now also addressed to custodian banks and other market participants. The ESBG believes that the practical implications of applying this Standard to these addressees are not at all clear from the current wording of the text and recommends that, as a minimum, the final text clarifies whether all or some specific elements of the Standards apply to this group, as mentioned under point 2.4 above. The ESBG would however prefer if these addressees were removed from the scope of application altogether. The application of this Standard to parties other than CSDs and CCPs would have certain strange consequences, which are certainly not desired. For example, how should one interpret Key Element 2? Does this mean that all market participants need to demonstrate to their supervisory authorities that they have a cost–effective back office system to clear and settle their trade transactions? The question of cost efficiency of intermediaries, such as custodian banks, should be regulated by market forces and competition and not by regulation. The situation is of course different for entities such as CSDs and CCPs, which may benefit from a quasi-monopoly position. Accordingly, the ESBG recommends strongly that custodian banks and market participants are removed from the list of addressees for this Standard.

Standard 17: Transparency

This Standard now also applies to “entities acting as custodians” and stipulates that they should provide sufficient information that allows their customers to identify and evaluate accurately the risks associated with securities clearing and settlement services.

The consequence of this provision would be to oblige large numbers of savings and retail bank in Europe to provide at least once a year the main statistics and balance sheet of the system operator as well as the aforementioned disclosure of the risk exposure and management policy of the custodian (Par 190) to millions of deposit holders. This would create a huge burden in compliance and excessive red tape and bureaucracy that might not be fully justified in terms of real benefit to the customers concerned particularly for custodian banks that serve mainly retail customers. The ESBG trusts that this is an “unintentional consequence”, as mentioned at the Hearing on 25 May and that ESCB–CESR will rectify this situation by excluding such custodians from the scope of the Standard.

Furthermore, the ESBG would like to stress that the investor protection rights of retail and professional customers are already very adequately covered by the conduct of business and investor protection rules in ISD 2. Given that risk management disclosure requirements for securities clearing and settlement players are not covered by the ISD, the ESBG believes that the application of this Standard to custodian banks would effectively constitute additional Level 3 type regulation, without having gone through the democratic decision–making process under Levels 1 & 2. This would contradict the spirit of the Lamfalussy procedure and is thus a reason for removing custodian banks from the scope of the Standards.

4. Conclusion

The ESBG trusts that the ESCB–CESR will take the above comments into account in the final version of the Standards. In particular, it would like to reiterate its strong recommendation that the Standards are maintained as a European benchmark of best practice for securities clearing and settlement systems and that ESCB-CESR delays the formal implementation of these Standards until they can be transposed as Levels 2 & 3 Implementing Measures under the proposed EU Clearing and Settlement Directive.