

**THE RESPONSE OF THE EUROPEAN CENTRAL SECURITIES
DEPOSITORIES ASSOCIATION (ECSDA)**

TO

**THE ESCB/CESR STANDARDS FOR SECURITIES CLEARING
AND SETTLEMENT SYSTEMS IN THE EUROPEAN UNION**

May 2004

The ECSDA

The European Central Securities Depositories Association (ECSDA) was formed in 1997 to provide a forum for national and international CSDs to exchange views and carry out projects of mutual interest in the field of securities clearing and settlement.

Recently, the ECSDA has enhanced its role from the mainly technical implementation of links between CSDs. ECSDA's general objective now is to offer solutions and to provide advice at international level on technical, economic, financial, legal and regulatory matters in order to reduce risk and increase efficiency in custody, pre-settlement and settlement arrangements for securities and related payments across Europe for the benefit of issuers, investors and market participants.

This is achieved by promoting:

- processing flows which ensure the highest efficiency with a low risk profile;
- a level playing field with the highest standards for entities providing custody, pre-settlement and settlement services;
- common standards to reduce or remove barriers to cross border settlement;
- the exchange of information on legal, tax, regulatory frameworks and market practices to foster the process of harmonisation across Europe, and
- international co-operation.

Four ECSDA working groups (viz, Public Policy, Harmonisation, Settlement links, Audit and Compliance) are dedicated to projects designed to deliver this ambitious role.

The ECSDA currently has 19 members, including CSDs and ICSDs, and maintains close and active links with other international associations of CSDs around the world.

Further details of the work of the ECSDA can be found at www.ecsda.com

Any questions or comments on this response should be directed to Giovanni Sabatini at g.sabatini@montetitolli.it

The ECSDA welcomes the publication of a further consultation paper on the above standards. For detailed comments on the background to ECSDA and the Association's views on the structure of clearing and settlement in Europe, we refer you to our response to the first Consultation published in October 2003.

We welcome that many of the changes that ECSDA suggested in its last response have been taken on board. However, we wish to point out that the market has only been given three weeks to comment on the standards. We believe that, given the importance of the issues for the future structure of European clearing and settlement addressed in the Standards, a longer period would have been warranted. Replying within such a short period has been complicated by the almost simultaneous release of the Communication from the European Commission on Clearing and Settlement in the European Union. Furthermore, co-ordination of the response has been exacerbated by the fact that ESCB/CESR Working Group has not identified the changes made from the last draft proposals.

Our main concern relates, indeed, to the consistency of the ESCB/CESR standards with the Commission's Communication (to which there is no mention in the Standards). We believe that it is essential that the European authorities take a consistent approach to issues such as the definition of functions in the settlement process. In particular, we note that the definition of core activities contained in paragraph 76 differ from the approach adopted by the Commission (which suggests a differentiation between services provided in an Intermediary capacity and those provided as an Issuer Securities Settlement System). This potentially divergent approach is not conducive to the development of a level regulatory playing field. Furthermore, since the Commission envisages the Standards to form the basis for Level 2 rules complementing the future framework directive, any inconsistency between approaches would introduce ambiguity within the European regulatory framework.

In addition, we note that while the functional approach to the regulation of providers of settlement services remains, it has been re-focussed on the standards dealing with DVP (Standard 7), finality (8), operational reliability (11), credit risk (9), and protection of customer securities (12). We encourage ESCB/CESR to ensure that this extension of the functional approach, which is essential to deliver a level playing field for settlement services across Europe, is not diluted further through the current round of consultation.

Other main comments of the ECSDA on the Standards are noted below.

Standard 2

ECSDA welcomes the emphasis which ESCB/CESR gives to expanding the use of matching utilities, but considers that the standard should be addressed directly at regulated markets since electronic trading and trade-confirmation are one of the main responsibilities for regulated markets rather than settlement systems.

We suggest that the standard is also applied to custodians that should grant the use of safer procedures than the ones currently used when matching instructions coming from indirect participants.

Standard 6 and 9

Standard Six now provides a more realistic and balanced assessment of the activities which CSDs may undertake. We note that CSDs are still required to mitigate the risks associated with their activities and, in the context of standard 9, provide exception based reporting to the regulators when the specific requirements of paragraph 107 cannot be met in full.

But we continue to believe that ESCB/CESR is placing undue significance on collateralisation as a means to reduce risk rather than recognising it as one tool in the risk mitigation process. We also believe that the Standards should recognise more fully the risk mitigation processes described in Basel II. We are unclear as to why the ESCB/CESR group is unwilling to embrace the work undertaken in the context of Basel II.

Standard 10

We suggest that the ESCB/CESR group reviews the use of the phrase “settlement agents” and the drafting of Key Element 4 in particular, clarifying to what extent, if any, the standard is meant to be extended to cover those payment banks which provide commercial bank credit to some settlement systems and their members in the EU or whether the standard is meant to be addressed only to those (I)CSDs which also possess a banking license.

Standard 19

As noted in our response to the first consultation, we believe that cross-systems links between CSDs are only one small channel used by the markets to execute cross-border settlement. We estimate that only around 5% of cross border settlement is delivered via this channel. Consequently, if ESCB/CESR is looking to reduce the risk of cross-border settlement, it should focus its attention on the links which agent banks and custodians maintain with CSDs and ICSDs across Europe and which handle around 90% of cross border activity. Focusing on (I)CSD links only re-instates the institutional approach to supervision which is inconsistent with the functional approach recommended in the ESCB/CESR standards.