



HELLENIC BANK ASSOCIATION

STANDARDS FOR SECURITIES CLEARING AND SETTLEMENT SYSTEMS IN THE EUROPEAN UNION

HBA welcomes the new report of CESR-ESCB (called hereafter the “group”) standards. HBA has participated in the first consultation that took place in 2003 and is happy to provide the group with comments for that new report. We consider that the group has taken into consideration many of the concerns raised during the first consultation, but we believe that some important issues are still outstanding.

We do believe that the new draft is at a large extent pre-empting the political debate about the future face of the industry in European Union. The group considers the standards as being “level 3”. But in fact there has been no level 1 or level 2. The standards while not having the force of law, they will be in practice binding, since all National regulators will endorse them. We consider that some of the standards will have adverse effects on the markets and we believe that the group should re-consider them.

As an overview we would say that the standards seem to create the following important issues:

They will impose additional burden to European banks that will impact their capital requirements. The door remains open for infrastructures to extend their activities to risky ones, without having studied in detail the existing practices. Banks, as members of those infrastructures, will need to review their risk exposure towards those entities, which will lead to additional capital requirements since these entities are actually risk free. The confusion regarding the roles that the various entities perform in the markets remains. To our opinion Securities Settlement (Infrastructure) Systems are exclusively the CSD related systems and not the commercial bank custody/settlement system capabilities, which have to interface and therefore fully comply with the encoded “rules” and “standards” of the CSD’s infrastructure system. Similarly, in the payments area we consider TARGET, EBA/Euro1, Step1 and Step 2 to be “the Payment Systems Infrastructures” and not the commercial banking payment capabilities, which also must comply with the encoded rules and standards of the “infrastructure providers”. The commercial banks are the intermediaries and therefore through their systems capabilities they bring their many individual (for retail or institutional customers) flows and paths of the transactions to a few “highways” which lead into the appropriate “system infrastructure” for “settlement” (CSD, FED, TARGET, EBA/Euro1, Step1, Step2, etc.). Consequently, the terms used in the draft CESR-ESCR standards document, such as “finality”, “DVP”, “settlement” and “cycles of settlements” relate, in our opinion, to rules and operating standards of an “infrastructure system” provider and NOT to an intermediary’s (custodian bank) system (whether large scale system or small one) as the standards document describes. Therefore, the document adds to our confusion when the new term “significant custodian bank system or systemically important custodian” is introduced hence equating “infrastructure systems” and “significant custodian bank systems”, with regulatory consequences. We believe that such an overlap could be the cause of a double costly regulation to the already sufficiently regulated bank segment.

Those standards create various competition issues:

- By isolating custodian systemically important from the other custodians
- By allowing CSD to perform custodian commercial activities (for instance on standard 5 securities lending) although they benefit from their central position and can have a view on the whole market.

If we examine the text in more detail we will notice that unfortunately the concept of “systemically important custodians” remains in the scope of application (standard 9). It stays without clear definition, which are the ones systemically important, and it is suggested to include additional requirements as part of the banking regulation. National regulators should assess the needs of further risk mitigation measures in particular focusing on operational risk, intra-day risk and should envisage to increase the level of collateralization. Identification of the institutions concerned would be assessed by National regulators with a European coordination to ensure consistency across Europe (std 18). This coordination would reinforce peers pressure to implement those standards at national level. The description of custodians’ activities shows a lack of understanding of what custodians do, which is demonstrated by the allegation that custodians are active in clearing – defined in the Standards’



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Glossary as “The process of calculating the mutual obligations of market participants, usually on a net basis, for the exchange of securities and money”. The use of the business volume of a custodian as compared to any national CSD as criterion for determining “systemic importance” is not substantiated. Substantiation will require an explanation on what risks the described activities give rise to, whether they are of an operational or financial nature, why existing banking regulations are insufficient to address these risks, what events could trigger the said systemic risks, and what consequences would affect the entire financial market of the European Union. It allows national regulators to determine, on a subjective basis, which banks are to be designated as “systemically important custodians”, without clear guidelines.

The singling out of “systemically important custodians” to be regulated as market infrastructures without demonstrating that they cause additional risk will ensure that users have to incur additional costs in choosing them as service providers, so that these “systemically important custodians” cannot compete effectively and must exit the business. Any custodian who gains market share and eventually become “systemically important” must also exit the business as they, too, will be encumbered by regulations designed for infrastructures.

Standard 5 includes provisions for securities lending activities by CSDs, without any distinction between opportunistic lending, which is a commercial activity entailing risk and usually for the purpose to cover short sales, and fail coverage. We firmly believe that CSDs should not be allowed to act as principals to take credit exposure for profit making purposes, but intervene only as a risk free facilitator.

Standard 9 creates issues related to credit and liquidity controls. CSDs are entitled to perform banking activities and take new risks if their national legislation allows it and if appropriate risk mitigation measures are implemented. CSD and ICSD are considered alike and there is no recognition that CSD with risk remains an exception in Europe. There has been no study as well on the impacts of introducing new risks within CSDs. CSDs’ credit offering is supposed to be limited to their clearing and settlement and asset servicing activities. However definitions are sufficiently vague to allow CSDs to develop the full custodian activities. For instance, CSD can develop any kind of securities lending activities. CSDs being of undisputed systemic importance should adhere to the highest standards of risk management. The “systemic importance of the settlement system” should not be a variable in the choice of controls. Credit extension is not a core function of a CSD and there is no market that can justify a specific “need” for a CSD to extend credit, except to maintain the status quo of ICSDs, which were started as banks as commercial enterprises and have always extended credit. CSDs ought to represent “absolutely safe” entities to conduct settlement and custody and their only concern should be the prudent containment of any operating and settlement risks. All custodian banks of any size heavily depend upon the sound and safe operation of the CSDs and this critical-central role should not be jeopardized. We should keep the CSD focus where it has always been globally in the marketplaces. This has worked. Banks could fail but it is inconceivable that a CSD may fail. If CSDs are allowed to take credit risk, they may be considered as too big to fail and thus create moral hazard, that is, the propensity to be imprudent in risk taking because of the implied safety net that it will be rescued by the government with taxpayers’ money. Banks are in the business to take market and credit risk and are appropriately regulated for them.

Standard 10 leaves the issue of using Central bank at the level of the simple recommendation and encouragement. We believe that the group should put this issue as a high priority one, since use of commercial bank money can be a source of instability for the whole system.

As mentioned in our opening remarks, while we recognize that some of the concerns raised in the first consultation were taken into consideration, we do believe, that the main issue of clear distinction between intermediaries and infrastructures has not been resolved and this leads to improper, to our opinion, proposals. We consider that standards 2, 3, 4, 12, 13, 14, 15 and 16 could be accepted, while standards 1, 11, 17, and 18 need further clarification.

Standard 1 needs clarification on what will be required from the so-called systemically important custodians.



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Standard 11 (Operational reliability) sets constraints on systemically important providers to resume business activities 2 hours after occurrence of a disruption and to enable a CSD or a CCP to meet its obligations on time. We need to ensure that these obligations are realistic.

According to Standard 17 (Transparency), entities acting as custodian should provide sufficient information that allows their customers to identify and evaluate accurately the risk associated with securities clearing and settlement services. We need to clarify overlap with existing banking supervision

Standard 18 (Regulation, supervision and oversight) calls for co-operation among the regulators and seems to us a bit unclear, we need to make sure that there is no overlap between regulations, and need to clarify individual competencies.

There is a number of standards though that create confusion between the roles of infrastructures and intermediaries and create to us major concern:

Standard 5 allows CSDs to lend securities as principal, on a bilateral basis and to access institutional investors' asset. CSDs should be allowed to cover failed transactions by operating a pool on behalf of CSDs participants and with no principle risk. We need to make a clear distinction between core and commercial functions. A distinction should also be made between fails coverage and lending to support short selling, as the risks of these two activities are significantly different.

Standard 6 allows CSDs to take risk and perform banking activities: credit extension, and asset servicing defined as activity of custodian banks. We ask for a clear separation of the value added functions that should be performed by a separate legal entity.

According to Standard 9, CSDs are allowed to take credit risk and provide uncollateralised credit. We believe that banks should be controlled according only to Basel II requirements.

Standards 7, 8, 10, 19 need clarifications in order to ensure a balanced regulatory approach. We would therefore urge the group to allow the market participants express their opinions in detail and this can only happen, by allowing a full second round of consultation. European Banking Federation has also made this suggestion and we believe it is a unanimous market request.