

Comments on the Consultative Report “Standards for Securities Clearing and Settlement Systems in the European Union” - CESR – ECB – July 2003.

Banca Intesa is the leading Italian banking group and one of the protagonists in the European financial arena.

Banca Intesa is the most important Italian securities services' provider, offering a full range of transaction products to support the activities of a diversified client base world wide.

Within the field of post-trading services, Banca Intesa provides an extensive array of products ranging from custody, clearing and settlement, in sourcing and clearing services for remote traders accessing the Italian market, derivatives clearing, “Banca Depositaria and Banca Corrispondente”.

Banca Intesa welcomes the opportunity to comment on the CESR – ECB consultative report and submits to your attention the following observations.

1. Banca Intesa supports the overall objective of the Working Group to adapt the IOSCO principles to the European environment, in order to ensure, among others, the safety, soundness and efficiency of the securities settlement systems in the Europe. These are general goods, and as such they need to be protected in the interest of the European financial markets.
2. Nevertheless, Banca Intesa wishes to signal its strong discontent about the risk-based functional approach chosen by the Group. This approach has the following consequences:
 - a) It disregards the legal status and the nature of the institutions to which standards are applied and places on an equal footing the infrastructures and custodian banks. We think this approach is not appropriate. Banks perform substantially different services than the infrastructures and operate in a different environment. In particular, banks serve clients and operate in a competitive context, whereas infrastructures are essential utilities, performing essential services for the markets. They mainly pursue a general interest service, and systems do not have clients, but users. These substantial differences should be taken in duly consideration in determining the scope of these standards.

- b) Custodian banks are already regulated by banking regulations and are adequately supervised by national authorities. Extending these standards to banks would duplicate the legislation applied to them and would put them at a competitive disadvantage against other institutions which combine both roles of infrastructure and bank. Moreover, should this approach be applied, credit risks could be treated differently whether provided by the same entity as a custodian or in the framework of its normal credit activity. We do not think this is desirable. Managing credit risks is an activity inherent to banking.
 - c) Such an extension would have an impact on post-trading costs, thus contradicting one of the aims of the European Union, which is to create the conditions for costs' decrease of cross-border transactions.
- 3. Banca Intesa has also reservations about the nature of the standards, which are soft laws. They could entail compliance problems if they are differently appreciated and enforced by the supervisory authorities (for instance in case of standard 9). An asymmetric enforcement of these standards throughout Europe could create an undesirable unlevelled playing field, distorting the competitive conditions for banks in the internal market. Banca Intesa would rather prefer having clear-cut rules applicable across Europe.
- 4. Banca Intesa does not support the one-size fits all approach that was used by the Working Group, as one can infer from reading for instance standards 9 (par.107),13, 14, 17, which are clearly applicable to infrastructures.

Although Banca Intesa's positions about the present consultative report are critical, it nevertheless understands the Working Group's ultimate aim, which is to preserve the stability of the European financial markets. We therefore suggest that a possible solution to the Working Group's concerns is strengthening the supervision on custodian banks by the competent authorities. Further obligations on banks might be envisaged only if their risk management tools were not able to manage correctly risks involved in the clearing and settlement activities.

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Comments on the Consultative Report “Standards for Securities Clearing and Settlement Systems in the European Union” - CESR – ECB – May 2004.

Banca Intesa is the largest Italian banking group and one of the main players in the European financial arena. It is the most important Italian securities services' provider, offering a full range of transaction products to support the activities of a diversified client base world wide. Within the field of post-trading services, Banca Intesa provides an extensive array of products ranging from custody, clearing and settlement, in sourcing and clearing services for remote traders accessing the Italian market, derivatives clearing, “Banca Depositaria and Banca Corrispondente”.

Banca Intesa' comments to the proposed standards include those of our subsidiaries in Slovakia, Všeobecná úverová Banka, VUB, and in Hungary, Central-European International Bank, CIB.

VUB is the second largest commercial bank in Slovakia, while CIB is the fourth largest bank in Hungary. These two banks offer custodian and safekeeping services for institutional and private clients.

Banca Intesa welcomes the opportunity to comment on the CESR – ECB second consultative report and expresses its appreciation for the constructive dialogue between regulators and market participants established during the recent second hearing.

Banca Intesa would like to submit to the CESR – ECB Working Group the following comments to the Draft Standards for Securities Clearing and Settlement Systems in the European Union.

General comments

1. Banca Intesa, as already mentioned in our comments to the first consultation' contribution (see attachment) fully supports the aims of the proposed standards, which is to preserve the European Union from systemic risks, to ensure the safety, soundness and efficiency of European securities settlement systems and to foster the protection of investors.
2. As already submitted, Banca Intesa does **not share the risk based functional approach** chosen by the Working Group, since it disregards the fundamental differences between services provided by infrastructures and by custodians banks and therefore making no difference between the risks

incurred by each of them. However, Banca Intesa acknowledges that the Working Group has taken on board some comments and suggestions put forward by the banking industry during the first consultation and it has tailor-made the proposed standards to the different entities involved in the securities clearing and settlement.

3. Banca Intesa maintains its **reservations about the legal instrument chosen for regulating the proposed the standards**. These should have been regulated by a Directive, thus making their implementation into national law mandatory and less subject to different, either more lenient or stricter, interpretation by the Member states (i.e. see par. 12(2)), par. 14 and standard 9). The risk of regulating the proposed standards with soft law is one of distorting the competitive conditions governing the provision of securities clearing and settlement services. **Banca Intesa would rather see these important standards being embodied in a Directive, to ensure a maximum level of harmonization and applied across all EU Member states in a uniform manner.**
4. While we agree on the need to ensure safety and soundness of the European securities markets, Banca Intesa acknowledges that the adoption of some standards will generate considerable developments and thus costs, especially for market participants established in the new Member states. Therefore, we believe that **costs and benefits** of all standards should be appraised and taken into account before their adoption.
5. The draft report does **not** give any **indication** about the standards' **implementation time**: the Working Group in the final report should give the addressees sufficient time to comply with new standards.

Specific comments related to the draft standards

Paragraph 12 (2): As already mentioned under point 3), these standards allow "Member states to impose additional, stricter obligations within their competence, e.g. prudential rules or rules of market functioning in order to take into account specific features of their domestic markets that affect stability and efficiency". Banca Intesa believes that Member states should not be able to impose stricter rules, so that a regulatory framework is established at EU level and therefore providers of clearing and settlement services are not put at a competitive disadvantage in a given Member state. Banca Intesa believes that these standards should foster maximum harmonization.

Paragraph 14: As far as the scope of the standards is concerned, the new version of the draft report assigns the task to determine whether a custodian operates "a systemically important system" to national regulators and overseers. While Banca Intesa understands this rationale, we would appreciate a predictable definition of harmonized objective criteria which national regulators and overseers will use in assessing custodian banks operating systemically important systems. The definition of common criteria would represent a "predictability factor" for all banks operating in the EU and a benchmark against which all banks could refer to.

Standard 1 - Legal framework: Banca Intesa endorses the rationale of the first standard, i.e. to clarify the law applicable to securities clearing and settlement systems in order to avoid conflicts of laws and to allow for the enforcement of rules in case of the insolvency of a system participant or an operator of the systems. However, we do not believe custodian banks should fall under the scope of this standard, as they do not operate clearing and settlement systems, but operate in a commercial environment and provide services ancillary to the actual clearing and settlement of securities.

Standard 2 – Trade confirmation and settlement matching: Banca Intesa fully supports the standard, being in the interest of the market that settlement transactions are matched as soon as possible and no later than the day before the specified settlement date. To encourage early matching, Banca Intesa supports where possible the introduction of economic incentives for early matching (or alternatively late matching penalties) which in turn, would provide an incentive for prompt and orderly transmission of instructions to the local market.

Standard 3 – Settlement cycles and operating times – Banca Intesa fully endorses this principle.

Standard 5 – Securities lending: Banca Intesa fully agrees with the principle of encouraging securities lending as a method to expedite the settlement of securities, since it is in the interest of the market to find mechanisms that reduce the failure of transactions in the delivery of securities. However, we believe that:

- a) **Custodian banks should not fall under the scope of this standard**, since securities lending is just one component of the normal activity carried out by banks, which is granting credit. Creditworthiness assessment and consequent risk management controls are the very essence of banks' activities. Banks should therefore not be caught under standard n° 9, since they are already submitted to banking regulation and to banking supervision.
- b) Although the legal orders of some Member states allow **CDSs to grant credit** facilities, in a theoretical perspective, they **should not** be given this possibility, since they perform a “central function in the overall settlement process”¹ and any problem arising in performing this activity would have an operational impact on their core activity with spill-over effects on the markets.

Standard 6 – Central Securities Depositories: Banca Intesa fully supports this standard. As already mentioned in our comments to standard 5, we believe CSDs should be **totally restricted from taking any credit risk**, because of the very essential role they play in the settlement of securities transactions. Furthermore the cost related to the additional capital requirements for extending credit as well as the cost arising from maintaining a risk management and counterparty assessment infrastructure by the CSDs would add to the overall costs to be recovered from its participants through the CSDs' revenue streams. Therefore we suggest to delete in the key element n°4 the wording “...CSDs should avoid credit and liquidity risks **to the greatest practicable extent**”.

¹ Paragraph 79, page 34 of the CESR-ECB draft standards.

Standard 7 – Delivery versus Payment (DVP): Banca Intesa is concerned that the possible externalisation of transactions and individual segregation of client assets at CSDs to support this standard will add to the overall cost to be supported by underlying investor to operate in a given market. Hence economic allowances and expense concessions on the related matching and transaction costs should be provided by CSD to participants in these cases.

Standard 9 – Credit and liquidity risk controls: Banca Intesa acknowledges that by not imposing *per se* a full collateralization of credit exposure to custodian banks offering credit to their clients, but leaving to national securities regulators, banking supervisors and overseers the task of “addressing the risk mitigation policies in order to ensure that they are in line with the risks the custodians potentially create for the financial system”², the present version of this standard better suits to the banking needs. Banca Intesa however still does not support the principle of applying this standard to banks operating systemically important systems, since they commonly use sophisticated risk management techniques and, unlike CSDs and ICSDs, are already submitted to capital requirements. Requiring more capital requirements for this kind of activity would put banks at a competitive disadvantage against infrastructures. Moreover this would have an impact on the costs of services provided by them.

As far as paragraph 114 is concerned, Banca Intesa would also like to stress the fact that there exist risk management techniques other than the collateralization of credit exposures that could better suit the custodian banks’ needs.

Standard 10 - Cash settlement assets: Banca Intesa adheres to the principle according to which transactions should always be settled in central bank money in order to ensure the safety of the system.

Standard 11 – Operational reliability: Banca Intesa adheres to the principle in question. In managing operational risk when confronted with out of the ordinary processing environment (disaster scenario or otherwise), specifically with respect to the availability of the and reliability of communication and messaging platforms for daily matching and settlement functions and processes, consideration should be given to favour and guarantee accessibility and reliability for those participants which are members to settlement systems that manage critically high volumes both in terms of transaction size and numbers.

Standard 12 - Protection of customers’ securities: Banca Intesa fully supports this principle.

Standard 13 - Governance: Banca Intesa can only fully agree with standard 13 and to its scope. The corporate governance requirements are particularly relevant for governing the operation of central facilities like CSDs and CCPs.

Standard 14 - Access: Banca Intesa fully shares this principle. Access to infrastructures like CSDs and CCPs is instrumental to guarantee that all providers of clearing and settlement services can have access to the infrastructures and can compete on a fair basis. We believe access can be denied only on the basis of

² See paragraph 114, page 48 of the CESR –ECB draft standards.

objective criteria, like the level of unacceptable risk the system could incur should the minimum requirement established by the service provider. We totally agree with paragraph 162.

Standard 15 – Efficiency: Banca Intesa supports the general concept that clearing and settlement systems should be cost-effective in meeting the requirements of users. We agree that this standard should be addressed to the so-called infrastructures, but we do not believe that custodian banks should fall under the scope of this standard. These in fact already operate in a highly competitive environment, unlike CSDs and CCPs, whose services cannot be circumvented. For this reason, the key element n° 6 should not apply to custodian banks.

We also believe that requiring interoperability at national and European level also among custodian banks should be more an objective for them rather than an obligation. If post trading costs of cross border transactions are to be reduced, they should first come from the interoperability of infrastructures.

Standard 16 – Communication procedures, messaging standards and STP: The adoption of international communication procedures and standardized messages would be useful in the case of cross border transactions. However a complete change of standards at domestic level entails significant costs.

Standard 17 – Transparency: Banca Intesa believes that transparency should always apply to all infrastructures activities, as they carry out monopoly activities. It acknowledges that the Working Group has adapted the standard by not extending *pari passu* the same level of transparency to custodian banks as it was in the previous version of the standards. These in fact do operate in a competitive environment and a level of additional disclosure would harm their competitive position in the market.

Banca Intesa agrees that the second pillar of the forthcoming regulation on capital adequacy could constitute a good basis of disclosure for custodian banks.

Standard 18 – Regulation, supervision and oversight: Banca Intesa can only fully agree with the standard in question and with the underpinning principles.

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