

cc: Dll

COMMENTS OF BORSA ITALIANA GROUP

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

JUNE 2004

We are pleased to comment the revised draft of the "Standards for Securities Clearing and Settlement Systems in the European Union" proposed by ESCB-CESR.

First of all, we would like to express our appreciation about the fact that many of our suggestions on the former version have been accepted and included in the current draft: that shows the usefulness of the consultation process whose effectiveness and transparency can greatly contribute to the quality and completeness of the work.

We welcome the extended application of most of the standards to custodians operating systemically important systems. We deem it very important in order to reach a level playing field and to better address the risks connected to clearing and settlement in the European Union.

As regards the proposed method to identify systemically important custodians, we support the approach chosen by ESCB-CESR that responsibility for identifying systemically important systems should rest on national regulators and overseers. Only national authorities, in fact, have the means and the powers to investigate whether the business conducted by some custodians and the related volumes can be the source of systemic instability. As pointed out in the ESCB-CESR paper, we appreciate the approach to compare the clearing and settlement activities of custodians with those of national CSDs in terms of volumes and value.

We consider this approach the most pragmatic one and we do not think that further follow up work (as in ESCB-CESR intention paragraph 25 in the "Follow-up work" section) in this area could lead to better results.

Finally, in order to promote full transparency, we would recommend the adoption of a specific provision stating that the list of operators of systemically important systems should be disclosed to the public.

We notice that when identifying the area of application, ESCB-CESR state the standards should apply to clearing and settlement systems in the European Union. Somewhere else reference is made to the non EU Member States of the European Economic Area.

Definitions are not used in a consistent manner too (e.g.: "operators of securities clearing and settlement systems", "core business of clearing and settlement", see page 4 and 6). We think more clarity is needed.

In accordance with the newly issued Communication from the Commission to the Council and the European Parliament "Clearing and Settlement in the European Union - The way forward", the ESCB-CESR standards may form the basis for Level 2 rules complementing a future framework Directive on Clearing and Settlement. For this reasons, it is very important that consistency between the two documents is granted. The standards cannot contain more stringent provisions than those to be included in the framework directive (please refer to the comment to Standard 6).

We have noticed that the most important changes have been made to Standard 6 and Standard 9. Notwithstanding the undeniable improvement to the text and the more realistic picture provided, we must point out that even the current wording does not provide a level playing field for CSDs and custodians performing clearing and settlement activities. Please refer to comments to the specific standards.

Standard 1: Legal framework

Par. 34 lists all the issues on which CSDs and CCPs are required to provide information. We notice that in the former version this obligation was generally addressed to "operators of the relevant systems" thus including, in our opinion, custodians operating systemically important systems. It would be useful to extend at least some of the disclosure obligations to those custodians (n. 5, 7, 8, 10, 11 with a particular reference to the use of collateral, 13).

Generally speaking, we would like to stress that these requirements would greatly increase the disclosure obligations on CSDs. Moreover, some of the listed subjects may require external legal

opinions that are usually very expensive and complex and may not have the effect of reassuring the users about the robustness of the legal framework.

We appreciate the standard has been extended to public authorities.

Finally, taking into account the questionnaires proliferation and the connected concerns regarding costs and efforts needed to answer, we urge that European authorities enter into appropriate consultations with non-European ones in order to reduce regulatory burden on CSDs and avoid disclosure obligations duplication (for example, a joint initiative of ESCB-CESR and SEC in respect of Sec rule 17f would be appreciated).

Standard 3: Settlement cycles and operating times

We would like to refer to the work of ECSDA regarding harmonisation of operating hours (Barrier 7 identified by Giovannini Group): all ECSDA members have committed themselves to comply to 10 standards (published on the ECSDA website: <http://www.ecsda.com>), i.e. *"all SSS who offer settlement in Euros should be open for Euro settlement for all types of financial instruments eligible in that SSS at least on all TARGET opening days."*

It is worthy to note that full compliance by all (D)CSDs with the ECSDA standards will not, by itself, remove the Giovannini barriers. This is due to the fact that other market sectors will have to adapt their practices too.

The chance to request market operators of regulated markets to be open during the TARGET operating times should be further investigated; at the moment, in fact, the opening times of the markets are determined in accordance with their participants' needs.

Standard 4: Central Counterparties (CCPs)

We suggest to introduce a distinction between clearing performed by CSDs and clearing performed by CCPs.

Considering that CPSS-IOSCO have released their draft Recommendations for Central Counterparties, we suggest to examine its contents as soon as possible. It is worthy that the issues regarding CCPs are addressed only in a specific document taking into account features and risks associated to the CCPs activity. Once finalized, all CPSS-IOSCO Recommendations should be adapted to the European environment enhancing efficiency and safety.

In the meantime, we observe that ESCB-CESR identify specific areas of interest regarding CCPs (par.29: access; business relationship with CSDs, links with CCPs...). As regards access, we notice that access requirements established by CCPs are an instrument to control risk. In this perspective the wording "open" access might be misleading: in fact, access should be granted if and only all the requirements are fulfilled. As regards the relationship with CSDs, there's no need for CCPs to ascertain CSDs practices provided that they perform their activity in compliance with the requirements of their relevant supervisors/overseers. As regards cost-benefit analysis and cost efficiency, it is hard to imagine how this standard could be implemented by the national regulators: in fact, it could actually result in a form of price control. Finally, as regards links with other CCPs, cross-border cooperation and coordination between regulators should be enhanced.

Standard 6 "Central Securities Depository"

We appreciate the fact that the standard now focuses only on credit and liquidity risk control and that CSDs are given the possibility to perform additional credit risk-free activities. Notwithstanding these improvements, we must notice that the current text of the standard is not completely satisfactory to us.

We notice, in fact, that the recommendation about not taking credit and liquidity risks "to the greatest practicable extent" remains in Key Element 4. In our opinion, this provision does not contribute to the creation of a level playing field because such limitation on CSDs' activities puts them at disadvantage compared with custodians and is a *de facto* violation of the functional approach. Moreover, this provision doesn't seem consistent with the European Commission Communication on Clearing and Settlement that doesn't prevent CSDs from performing activities that entail credit and liquidity risks.

Finally, we would like to remind that the Commission intends to state a capital adequacy requirement for securities clearing and settlement systems taking into account the one at present applicable to banks in respect to credit risk. This provision and the mitigating measure required by the standards could be sufficient to properly address risks without asking CSDs to avoid them. In this respect, Key element 5 could be deemed sufficient.

Standard 7: Delivery versus payment

We don't see why the word "actual" has been removed from the text of the standard and from Key element 2 but left in Key element 3 ("actually").

Par 86: we believe custodians should ensure DVP settlement (cancel to the "greatest practicable extent") as current banking regulations do not ensure the elimination of principal risk.

Par. 89 describes only a method through which DVP can be achieved: some systems, in fact, perform DVP via the contextual credit of securities/debit of cash and vice versa.

In par. 91, maybe a definition of initiating/ receiving CSD could be helpful.

The requirement of cross border DVP as specified in the standard is currently hampered by barriers on efficient cash exchange and not feasible at the moment, especially for CSDs without banking status. If the standards become effective before the introduction of TARGET 2 in 2007, it should be pointed out that, in the interim phase, FOP links might be sufficient.

Standard 8: Timing of settlement finality

We would like to refer again to the report published by ECSDA: ECSDA (I)CSDs committed to *"support efficient cross-border settlement in Europe by providing intraday finality in real time or by at least one settlement cycle per hour [...]"*.

We appreciate the reference to Central Banks in Key element 7 (TARGET 2 should be built in a way to facilitate cross-border cash exchange in safe Central Bank money) but we think also cash agents should be quoted in the Key Elements because it is very important that intraday finality is granted also in those systems that do not offer settlement in Central Bank money at the moment.

Standard 9: Credit and liquidity risk controls

We appreciate the fact that the standard now focuses only on the credit and liquidity risk controls. Notwithstanding the improvements to the content, perplexity remains as regards the discrimination between CSDs and custodians operating systemically important systems.

First of all, the standard (and par. 106) refers to national legislators power to allow CSDs to grant credit. We notice that:

- the European Commission Communication does not prevent systems to grant credit. Considering their role (Level 2 Regulation), the standards cannot contain more stringent provisions than the one of the future framework directive on C&S;
- if national legislators do not authorize the granting of credit, non authorized CSDs would be in a unfavourable position in respect of the authorized ones and a level playing field would not be created between CSDs and custodians that would keep on providing C&S in addition to their ordinary activities.

We notice the standard distinguishes between CSDs and custodians operating systemically important systems. While the picture is clear for CSDs (limitation to take credit and liquidity risks and full collateralisation) the same is not true for custodians: in fact, ESCB-CESR state that national regulators/supervisors will "address the risk mitigation policies". It seems not likely that this provision creates a level playing field.

If Basel II applies uniformly to custodians and to CSDs having banking status this must be mentioned in the standard itself not only in footnote 1 on page 46.

Standard 13 (Governance), 14 (Access), 15 (Efficiency)

We point out these standards address issues that are also included in the Commission Communication. As a consequence, consistency with the Commission proposal must be granted.