

Deutsche Börse comments on the Preliminary Progress Report by CESR: “Which Supervisory Tools for the EU Securities Markets?” (Ref.: 04-333f)

General comments

Deutsche Börse Group appreciates being given the opportunity to comment on the proposals put forward by CESR on the future of European securities market supervision. As an international company providing the complete value chain from trading to clearing, settlement and custody, Deutsche Börse Group supports efforts that aim at improving EU-wide regulation of the securities industry. With the overwhelming majority of FSAP directives being completed at level 1, this seems like a particularly apt moment for reflecting on the further development of European securities supervision.

We generally support the reflections of CESR about a strategy for the further harmonisation of securities markets supervision. However, we would like to make two major suggestions:

- CESR should make it clear that the quality of supervision in the EU entirely fulfils global standards. It is rather the efficiency of supervision for which there is still potential for further improvement.
- CESR should further emphasize that the establishment of a central European financial supervision is a long term project and that it is the prerogative of the Council of the European Union, European Commission and the European Parliament to initiate any steps to be taken in this direction.

More specifically, we would like to comment upon the following issues raised in the progress report:

- How integrated is the EU securities market? (I), pp. 6ff)
- The adaptive improvements of the network of securities regulators (II b), c), pp. 12ff)
- Improvements that might be considered by EU institutions (II d), pp. 16f)

How integrated is the EU securities market? (I), pp. 6ff)

While we generally support financial market and regulatory integration in the context of global convergence, we would like to point out that the current framework in the EU already offers opportunities for the successful cooperation of supervisors of companies that are active

in various member states. Generally, it would be useful if CESR came up with more practical examples of where it believes that national regulators have not cooperated sufficiently. We would like to give two examples that we feel illustrate the status quo of regulatory cooperation in the EU: the cooperation between the German and the Luxembourg supervisory authorities BaFin and CSSF for Clearstream International, and the approval of European participation in Eurex US by EU regulators.

Clearstream International is a cross-border provider of post-trade services and a 100% subsidiary of Deutsche Börse AG. It consists of Clearstream Banking Luxembourg and Clearstream Banking Frankfurt, and is therefore based both in Luxembourg and Germany, with representative offices all over the world. Due to this cross-border structure it was essential to establish a co-operation framework based on mutual respect and recognition of domestic regulatory environments. The German and the Luxembourg regulators BaFin and CSSF have arrived at such an arrangement in the form of a memorandum of understanding that has turned out to work well in practice. This example demonstrates that, even without any legal or institutional changes at the EU level, regulatory cooperation can be made to work.

Another example worth pointing out is the process of regulatory approval of Eurex US by the various regulators in home countries of Eurex remote members. Although the German regulator BaFin was very helpful in coordinating the process, the necessity of receiving admissions from such a wide variety of authorities working in different national legislative environments made the process calculable, but lengthy. It seems worth discussing whether a common deadline for the approval such ventures, which, after all, potentially increase the competitiveness of the EU financial sector, could be introduced.

However, these examples also demonstrate that, while there is potential for increasing the efficiency of EU-wide supervision, the quality of regulation already reaches a high and satisfactory level.

The adaptive improvements of the network of securities regulators (II b), c), pp. 12ff)

In the long run, a single EU financial regulator along SEC lines may well be advantageous, but as a short term measure, national equity culture, as well as civil and corporate law is far too diverse to justify the creation of such an entity. This seems to be acknowledged by CESR, insofar as they limit most of their proposals to changes within the current legislative framework. However, some of their proposals for developing their supervisory “toolbox” amount to a redefinition of the role of CESR. As suggested in the title of the corresponding part of the CESR paper, the “toolbox” should remain adaptive and not attempt to shape the integration process.

Questions such as the degree of convergence of securities supervision (p. 12) or the repeated self-description as “supervisor of national supervisors” (e.g., p. 3, 15), at least for the time being, go beyond the mandate of CESR. They are the prerogative of the European Commission, the European Parliament, and the European Council. Also, a “pre-clearance’ at

CESR level” (p. 14) seems questionable since it undermines the regulatory responsibility of national institutions that are accountable to democratically elected governments.

Furthermore, CESR suggests it might take over tasks prescribed in the Markets in Financial Instruments Directive and the Transparency Directive, such as transaction reporting or the storage of regulated information on issuers (p. 16). Again, this is questionable since CESR so far lacks the technological know-how to establish and operate such complex IT operations. Especially for issuer information, commercial service providers with a track record in the distribution of financial information are to be preferred.

Therefore, at the present moment, we would like to caution CESR against attempting to assume the role of a European SEC in the making on its own initiative. In the short run, CESR should limit its role to that of a coordinator of national competent authorities with the main tasks of providing the European Commission with consolidated advice on the implementation of directives concerning the European securities market as well as the coordination of their transposition into national law, as foreseen in the Lamfalussy procedure on level 2 and 3. We need more experiences on level 3 and 4 before further actions should be taken.

Furthermore, it needs to be emphasized that any possible extension of the scope of CESR in the long run has to take place within the co-decision procedure foreseen at the EU level, i.e. with the approval and under the supervision of the European Parliament, the European Commission and the Council of the European Union (see also our comments on part II d) below on p. 4). CESR needs to remain firmly accountable to these EU institutions, and any extension of the regulatory powers should go hand in hand with the development of an institutional setup to ensure this accountability.

Improvements that might be considered by EU institutions (II d), pp. 16f)

Chapter II d) discusses areas in which “single EU decisions” (p. 16) might be useful. This, CESR specifies, “would require upgrading the legal profile of CESR” (p. 17). In this context, the question is raised: “Could certain trans-European market infrastructures (exchange and related, clearing and settlement services...) that would expand significantly in a number of Member States and for which the supervisory arrangements based on the Home/Host(s) relationships (and their possible improvements) would appear to be insufficient, be more efficiently supervised at EU level?” (p. 17).

For entities with cross-border activities, it could indeed come as a relief if they were supervised only by a single regulator or a lead supervisor. Such a streamlining of regulatory responsibilities could involve significant synergies both on the side of the authority and the regulated entity. It is, however, not acceptable that “market infrastructures”, as CESR calls them, should be given a special treatment in comparison to banks and other financial services providers. This would contradict the principle of functional regulation, i.e. the equal regulatory treatment of equal functions, irrespective of the institution by which they are performed. Since banks, as operators of post-trade infrastructures, that are about to be regulated on a European level, enter into a direct competition with operators of regulated

markets, unequal regulatory treatment would prevent the emergence of a level-playing field. The same is true for banks as potential operators of internalising systems or multilateral trading facilities, as defined by the Markets in Financial Services Directive. Therefore, while EU-wide supervision of cross-border service providers should indeed be strived for in the long run, it should be introduced for all such entities in the financial sector.

Furthermore, it needs to be kept in mind that national legal systems in the financial sector, all efforts at increasing harmonisation notwithstanding, remain diverse. Therefore, even if CESR were capable of taking single EU decisions, their implementation on the national level would still be different in each member state, or these decisions could even conflict with national law.

As the paper frequently points out, it is one of the prerequisites of improving the cooperation between national securities regulators that all competent authorities have equal competences. This, however, may contradict the wider legal tradition of the various EU member states. In continental Europe, for historical reasons, regulators have no powers of using police methods to prosecute, e.g., persons suspected of insider dealing. By contrast, in the UK, like in the US, this situation is different. It seems unlikely, however, that such traditions, having far-reaching implications for the legal system as a whole in each member state, will be changed easily. We would therefore caution against exaggerated ambitions to streamline the regulatory powers of supervisors.

It also seems worth emphasizing what CESR itself notes in the report: “Any supervisory issues that would require a single EU decision would need to be identified and selected in advance through a transparent and democratic process. Such a selection would have to be done progressively, once the conditions are met, through modification by co-decision of the existing directives by the placing the current mutual recognition system by a single EU decision system” (p. 16). This underlines the long-term nature of any effort to introduce the possibility of single EU decisions, and the necessity to proceed within the established democratic framework (see also the last paragraph of our comments on sections II b) and c)).

In this context we would also like to point out that it is not only the efficiency of the CESR decision-making and supervision process that matters, but also its effect on the efficiency of the entities they supervise. The Lisbon Agenda has set down the objective to turn the EU into the world's most dynamic and competitive economy by 2010. The securities sector is one of the few in which this aim has already been reached in many respects. European exchanges are the largest and most efficient world-wide by indicators such as number of contracts traded, market capitalisation of operators and implicit transaction cost. We would suggest including a commitment to support the creation of liquid capital markets and efficient financial infrastructures that are globally competitive in the CESR mission.

We look forward to the discussion on this important topic and would be glad to further contribute to the consultation process.

Frankfurt/Main, January 2005