

CESR CALL FOR EVIDENCE

**Formal request for technical advice on identification of regulatory arrangements for post-trading infrastructures and to advise on possible solutions in terms of bridging any potential differences in these arrangements
September 2008**

Intesa Sanpaolo, one of the largest banking and financial groups in Europe, active in the trading and post-trading business, is grateful to CESR for the opportunity both to contribute with its experience to the analysis CESR is currently carrying on and to express its views on the possible solutions to address the issues of post-trading infrastructures.

1. Brief assessment of the post-trading market

According to a widely shared industry analysis, the high costs of post-trading often flow from the lack of interoperability and mutual access among post-trading infrastructures, in particular as far as CCPs are concerned. The implementation of Mifid and the adoption of the Code of Conduct in November 2006 have increased the internationalisation of post-trading infrastructures, as the recent establishment of transnational trading venues and CCPs proves, and improved price transparency, as the prominent publishing of the prices on the website of market infrastructures since 1 January 2007 confirms. However, the more than seventy pending requests for links and the still high prices provide clear evidence of the current failure to achieve a true interoperability among post-trading infrastructures.

We believe that the reason of this failure mainly lies in the fragmentation of the regulation over CCPs and CSDs, which is still largely national. As pointed out also by the European Central Bank¹, there is scarce regulatory convergence with respect to the identification and management of the risks of CCPs. Moreover, at an even more fundamental level, we observe that not all national regulators take the same stand on whether a CCP should be authorised to take certain risks, such as those connected with the management of the collateral. This different regulatory approach, where each national supervisor applies its own prudential standards to the CCPs intending to establish a link with the CCP supervised by it, constitutes a major obstacle to set up links among CCPs.

¹ See <http://www.ecb.int/events/conferences/html/ccp.en.html> and <http://www.ecb.int/pub/pdf/other/rolecentralcounterparties200707en.pdf>

In the light of this fundamentally negative assessment of the current regulatory framework, we welcome the Commission's and CESR's interest in this matter and provide herebelow our views on the possible solutions in terms of bridging the differences among infrastructures, rather than outline the features and differences of the current regulatory arrangements, which regulators and supervisors are undoubtedly better placed to execute.

2. *Goals to be achieved*

We are convinced that every action of the legislator to regulate at European level post-trading infrastructures should be aimed at achieving the following main goals:

- (i) Systemic stability. CSDs and especially CCPs are core elements of the stability of financial markets, given that they match all orders and payments and provide for the registration and the delivery of the securities. If a CCPs went bankrupt or simply failed to carry out properly its matching and settlement functions, the trading venues and the financial institutions linked to it could not perfect the transfer of the traded securities and therefore, *inter alia*, would not fulfil their contractual obligations with the investors. Moreover, since the settlement of debts and claims made by CCPs is at the basis of the whole risk and collateral model of banks and financial institutions, there follows that CCPs need to be bankruptcy-remote and – as far as possible – risk-remote. A clear indication of central role of CCPs and CSDs for the stability of the financial system is the competence of Bank of Italy, and not of Consob, for the supervision over these institutions. In fact, according to Article 5, paragraph 2, of the Legislative Decree 24 February 1998 n°58 ² “the Bank of Italy shall be responsible for risk containment, asset stability and the sound and prudent management of intermediaries”. On a contingent note, in view of the current turmoil of financial markets and of the possibility that major banks and financial institutions are declared bankrupt, a careful and especially prudent approach with respect to the essential goal of ensuring the stability of the system looks all but unjustified and unjustifiable;
- (ii) Increased market efficiency. As the current market experience illustrates, the market inefficiencies, and therefore higher prices, due to the extremely limited interoperability among post-trading infrastructures should be eliminated. By introducing some legislation setting the conditions for linking and providing for a higher degree of legal certainty, it is to be expected that the creation of links among CCPs will be fostered. The experience of multi trading facilities, which have significantly developed after the enactment of Mifid, can be quoted in this respect. The introduction of a common regulatory

² http://www.consob.it/main/documenti/Regolamentazione/normativa/dlgs58_2004.htm#Art._5.

playing field among CCPs and CSDs would also foster competition among players and bring lower prices and higher quality standards;

- (iii) Increased financial institutions' efficiency. If CCPs were linked and connected to each other, then financial institutions could concentrate in a single CCP all their trades, irrespective of the actual trading venue. Such a concentration would also have the major side effect of improving the collateral management in connection with the settling of transactions at CCP level;
- (iv) Clear supervisory competences. A regulatory framework aimed at allowing interoperability should necessarily provide for a clear allocation of competences among supervisors, so that no gray zones exist, irrespective of the complex cross-border activity of post-trading infrastructures.

3. *Proposed solution*

Taking into account the current fragmented regulatory framework and the goals to be achieved, we maintain that only a mandatory piece of European legislation, possibly a directive, can provide for the necessary legal certainty and the comprehensive legal arrangement, on the basis of which an acceptable level of interoperability can be achieved.

In this respect the European legislator has an array of possibilities, such as maintaining the national differences and simply provide for a common minimum to introduce mutual recognition, or introducing a minimum harmonisation or a maximum harmonisation regime, or setting up a new comprehensive set of rules for post-trading infrastructures. Although each solution has its own costs and benefits, Intesa Sanpaolo advocates for the introduction of a common uniform regime of European origin, which supersedes over existing national regimes. Such a regime, to be crafted similarly to the Capital Requirements Directive for banks, would bear the major benefit to be originally and organically designed for post-trading infrastructures open for access to other institutions and to avoid the loopholes and possible inconsistencies flowing from the jigsaw of differently conceived national laws.

In our opinion, such piece of legislation should deal with the following major issues:

1. *Setting the conditions for the authorisation and granting of a passport* to CSDs and CCPs, among which an capital requirement (i.e. higher than the one provided for banks and financial institutions), a proper organisational structure and a sound risk management;
2. *Providing for compulsory company independence* of CSDs and CCPs. Such a provision would ensure that the post-trading infrastructures act independently and assess objectively all the

subjects requiring access to them. Furthermore, it would significantly limit the possibility that conflicts of interests arise;

3. *Identifying the scope of business of the various players.* In this respect a clear distinction between CCPs and CSDs, on one side, and banks and financial intermediaries, on the other side, would be advisable. Such a distinction would ensure that post-trading infrastructures are dedicated to their core business and only take the risks arising from that business. On the opposite, if they were treated as banks, they would have the same level of risk and bankruptcy remoteness of banks, which in our opinion is not acceptable in the light of the higher systemic risk infrastructures entail;
4. *Introducing a minimum set of conduct of business rules.* As already provided for banks, the legislator could introduce a two tier regime, thus providing for a more limited scope of business for less sophisticated players and for an advanced and broader scope for infrastructures that prove to have the skills to manage the more material risks incurred;
5. *Setting the supervisory framework.* In order to avoid duplications and especially loopholes, we believe that the optimal solution would be to provide for a sole supervisor for all post-trading infrastructures. However, we understand the major political and organisational hurdles that such a decision would carry and – as a second best – we suggest to provide for a home supervisor, which is competent on the company, capital and organisational requirements and general management of the infrastructure and for a host supervisor, which in turn is competent for the supervision of the collateral and liquidity management.

Alongside with a piece of legislation over post-trading infrastructures, it should carefully considered whether it is necessary to provide for a European insolvency framework of said entities, along the same lines of the insolvency regulations for banks and insurance companies.

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