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For the attention of

Mr. Elias Kazarian
European System of Central Banks

Wim Moeliker
Committee of European Securities Regulators 21 May 2004

via e-mail to: **secretariat@cesr-eu.org**

Dear Sirs

ESCB-CESR: Draft Standards for Securities Clearing and Settlement Systems in the European Union

1. **Introduction**

   In response to the second call for contributions to the ESCB-CESR Draft standards on this subject, we are writing to set out the principal concerns of LIBA members.

   A list of LIBA members is available on our website, from which you will see that LIBA members comprise the principal European and international investment banks. This contribution to the debate has been made from the perspective of LIBA members as users of securities settlement systems and as consumers of custody services.

   In the time available, we have chiefly restricted our comments to serious, high level concerns. We set out our concerns about process, identify welcome aspects and areas of disagreement and note an open issue about the status of the explanatory notes. We may have further comments to make at a later stage when we have completed a fuller evaluation of the proposals.

2. **Process.** Here, we have two principal areas of concern:

   a) **Consultation period.** Given the importance of these standards, we welcome that CESR has entered into a second round of consultation on this subject. Wethink however that, given the highly complex nature and importance of the subject, more time should have been allocated for this second round, rather than a rather rushed second phase. We draw your attention to CESR's own standards for consultation, which state that "if the response to the first consultation reveals significant problems, or where revised proposals are radically different from the original proposals on which consultation was

based" there will be a second consultation. We do not believe that market participants are being given sufficient time to respond. For less well-resourced groups, including consumers, the problem must be more acute. This cannot be characterised as a "real second market consultation". It is particularly unfortunate, because there has been a good dialogue with the market and stakeholders up to now.

b) **Quasi-legislative approach.** The commitment by regulators and central banks to use their influence on governments and legislators to implement the standards as part of national law should not be allowed to cut off the process of establishing a national and European consensus on these questions. This is particularly important in the light of the industry's concerns about consultation practices, both at IOSCO generally and in particular in the case of this specific topic in Europe. In addition, the forthcoming debate based on the Commission Communication represents an opportunity to settle the main axes along which public policy should be oriented. It is unfortunate that that debate did not precede the publication of these revised proposals. We hope that the lessons learned from the preparation of these standards will be applied in developing a work plan following the debate on the Communication. Such a work plan need not necessarily include legislation at European level.

3. **Welcome aspects**. We welcome a number of aspects of the revised proposals. In particular:

a) **More appropriate differentiation between regulated custodian banks and utility-type systems.** Standards 13 (Governance), 14 (Access) and 17 (Transparency) have now taken into account in a more appropriate manner the very different regulatory status of custodians banks as compared with CSDs.

b) **The competition authorities should deal with allegations of breach of competition law.** We also agree that there is only room for one regulator with responsibility for economic regulation. The recommendation to supervisors to bring anti-competitive behaviour to the attention of the competition authorities is welcome, with two qualifications. First, there is a risk to the quality of the supervisory dialogue if operators of systems believe that material which is passed to one regulator for one purpose can be passed to another regulator who would otherwise have to make the case for obtaining it. Secondly, our understanding of the most recent, well-known case involving alleged anti-competitive practices by a provider of settlement infrastructure is that the EU authorities' action was triggered by a complaint from the operator which was shut out of a particular market, not by the supervisor of the entity allegedly shutting the competitor out.

c) **The changes to the collateralisation requirements.** We welcome the revisions to the requirements relating to the provision of collateralised credit, with one major reservation. At a time when considerable efforts are being made to make the European market more efficient, we regret the fact that there is an 'uneven playing field' implicit in the proposal that custodians will be subject to different regimes depending on the national regulator's view of the significance of their systems. We do not agree to the extension of this standard to financial intermediaries, even where such intermediaries are of systemic

importance, as the taking of risk by such entities is adequately taken account of by the relevant prudential regulation, and as it should also – in the interest of systemic stability – not be discouraged. We are in favour of collateralisation in a CSD environment; in a custody environment, we believe that a custodian bank regulated under prudential supervision rules should be able to deploy the risk mitigation measures of choice, which may include the taking of collateral in some circumstances.

4. **Principal areas where we disagree.** We set out a brief statement of the principal areas where we disagree or have concerns as follows:

   a) **The common, functional approach should be risk based and proportionate.** We welcome the development of a common approach to the supervision of clearing and settlement systems. However, we think that not "functional regulation" but rather "risk-based regulation" should be the overall guide for regulation also of this sector, as regulation should in no case impose regulatory standards that are not justified by the relevant risks imposed by a relevant activity. In a lot of instances it is appropriate to treat the same functions differently, for example depending on whether they are performed by an entity subject to prudential regulation or not. Within a risk-based framework, the relevant functions performed by a relevant regulated entity will obviously need to be addressed.

   b) **Risk of protectionist behaviour by EU member states**. The suggestion that member states can impose "additional, stricter obligations within their own competence, e.g. prudential rules or rules of market functioning in order to take into account specific features of their domestic markets" must not be used as a cloak to introduce provisions which fetter access to EU markets.

   c) **Systemically important systems.** LIBA members are major users of systemically important systems. We do not believe that individual national supervisors are necessarily best placed to assess the importance of a particular system in the increasingly integrated European financial system. In a Union in which such a substantial proportion of financial market activity is denominated in the single currency, it will be essential for supervisors to co-ordinate their approach. Building market confidence can best be done through transparency by the supervisors.

   d) **Extension of operational standards to custodians.** We strongly disagree with the extension of operational standards like "real-time settlement", "settlement finality" and "delivery versus payment" to custodians. In the period leading up to the implantation of the Euro these standards took on technical meanings which really only apply to settlement of securities in the books of CSD and cash in central bank money. Appropriate good practice guidance for agent banks would need to be written quite differently.

   e) **Scope.** We continue to believe that the distinction between custodians with and without systemic importance is not appropriate in the context of a number of standards. While we appreciate that the regulatory approach should be calibrated by reference to the risks posed by the particular institution, we think that the same standards should apply to all custodians. The applicable

standards are those of Basle II rather than these standards. A particular advantage of adopting this policy is that the difficult question of defining 'systemically important' falls away.

f) **Providers of post-trade services.** As we said in our original submission, we continue to believe that "the standards are relevant" to providers of post-trade services other than securities settlement. We also continue to believe that "the standards are not *applicable* [emphasis added] to such providers, since such providers (and providers of software and consulting services with which they co-operate and compete) are not regulated. It will be for the industry to work with its regulators to define the practical implications of the proposed standards and communicate this to the supplier community." Secondly, since publication of the CPSS-IOSCO standards on securities settlement systems ("SSS's"), CPSS-IOSCO has now published standards for CCP's. Central counterparty issues should be addressed through the framework of those standards, not through the inappropriate extension of the standards for SSS's.

5. **Concern about the status of the explanatory notes.** While we believe, generally speaking, that the standards themselves are standards with which we agree, we are concerned about the status of the explanatory notes. It should be made clear that these notes are not intended to be part of the standard.

6. **Conclusion**

In conclusion, we believe that the application of the CPSS-IOSCO standards to CSDs and CCPs will be a positive contribution to the development of European markets. We do not, however, believe that extending the scope of application of those standards to cover 'systemically important' custodians is appropriate. We would recommend further collaborative work by banking and securities supervisors at a European level with market participants to consider how best to address these concerns.

If you would like to discuss any aspect of this response with LIBA or its members, please contact me at the address above.

Yours sincerely,

John Serocold
Director