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Mr Arthur Docters Van Leeuwen
Chairman
Committee of European Securities Regulators
11-13, avenue de Friedland
75008 Paris
France

**Request for Appropriate and Meaningful Consultation Regarding
the Draft Standards on Clearing and Settlement**

24 May 2004

Dear Mr. Docters van Leeuwen:

With more than USD9.4 trillion in assets under custody and in excess of USD1.2 trillion under management, State Street is a world leader in financial services. State Street joins the unprecedented call of the banking industry across Europe demanding that the Joint Working Group of CESR and ESCB only finalize its work on the draft clearing and settlement standards after complete and fully transparent consultation.

The revised draft standards present new, complex and controversial issues, all bearing upon the future structure and functioning of the securities markets in Europe, and it would be unbefitting for any regulatory or supervisory process to complete such a major initiative without allowing for meaningful consideration of the analysis and commentary from those who would be most directly impacted by its outcome.

State Street reserves its right to submit full comments on the revised draft standards within an appropriate consultation process, but identifies some of its concerns below:

- The Working Group's purported "deepening and strengthening of some of the CPSS-IOSCO recommendations" is not supported by any concrete facts or examples of material omissions in either CPSS-IOSCO's risk analysis, or current bank regulation or supervision. (Para. 7)
- "Systemically important custodians" continue to be included in a number of standards as if they are CSDs, notwithstanding the fact that the Working Group now recognizes the unique public interest and de facto monopolistic role of CSDs, a role which no custodian replicates. (Para. 14)



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- 2 -

- The only justification in the 94-page revised report for including “systemically important custodians” is to be found in the imprecise, confusing and largely misleading 12 lines of Paragraph 14. This is hardly the basis for sound regulatory activism. (Para. 14)
- The Working Group for the first time in this debate identifies “internal settlement” as a possible driver for its inclusion of “systemically important custodians” within the standards, but without any analysis as to the extent of, or risks presented by, such activity, nor any explanation that such risks are somehow not addressed in current banking regulation or supervision. (Para. 14)
- The revised report fails to mention, or address any of the issues raised in, the European Parliament’s Andria Report. The revised report also surprisingly pushes the European Commission to follow the work of the Working Group, when the role of CESR in the Lamfalussy process is a technical one, not a policy-making one (though the proposed Standards unequivocally seek to establish critical market policy). (Para. 20)
- Standard 1 reinforces the current propensity of CSDs to extend the use of non-negotiable and non-commercial contractual provisions, even when offering competitive, commercial services. This is inconsistent with promoting competition in the market. (Para. 33)
- Standard 5 clearly promotes a centralised market infrastructure model relative to the offering of what are currently commercial securities lending services. It also contemplates CSDs acting as principal in that capacity, without meaningfully addressing the very considerable systemic risk that this would create. (Paras 69-71)
- Standard 6 opens the door for CSDs to take on credit risk activities, including “non-core” commercial activities, without apparent limitation. CSDs will predictably do so by relying on their de facto monopoly position to extract non-competitive and non-commercial collateralization and other requirements from participants, a position which will have been brought about and validated by these Standards rather than by market forces (Para 79)
- Standard 9 both (i) supports the ability of CSDs to offer commercial services provided such services are collateralized – presumably by participants as discussed above, and (ii) while recognizing the role of banking regulators and the Basle capital structure, nevertheless calls for collateralization levels of custodians to be increased. It fails to distinguish between the role and regulation of CSDs and custodians. It also fails to permit securities being processed for settlement to be automatically pledged as collateral for the corresponding payment obligation. (Para 114)
- Standard 11 also fails to distinguish between market infrastructure entities (such as exchanges, CSDs, CCPs, etc.) and participants (such as custodians and other intermediaries). The public policy objectives behind the business continuity requirements imposed on infrastructure entities suggest more robust recovery timeframes (consistent with those proposed in the draft standard) than for participants, as was recently determined by the US Federal Reserve. (Para 134 etc.)
- Standard 17 would purport to require custodians operating in a highly competitive environment to publicly disclose proprietary and service-distinguishing information, as well as fees. This is not commercial or workable in the market place. (Para 189)
- Standard 19 (while totally transformed from its original CPSS-IOSCO construct) should require full disclosure to participants by CSDs of a full and appropriate risk analysis of all links.



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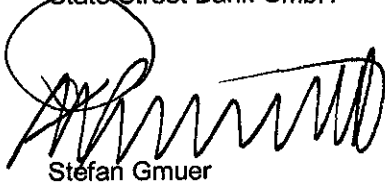
- 3 -

- Finally, the new Glossary – while a fine concept – will need substantial work to reflect accurate functional definitions.

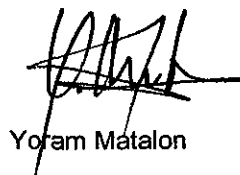
State Street has already expressed its support for greater efficiency and risk mitigation in the European financial market. However, while we support the concepts in the CPSS/IOSCO recommendations, the continued inclusion of custodians within the scope of the revised report is not only misguided but fails to address what appears to be the Working Group's principal concern, i.e., internal settlement. The standards, once finalized, should also serve the market prudently and equitably, and this will only be achieved if the standards carry with them the support and confidence of the industry. The course currently being contemplated for finalizing the standards will not lead to this objective.

As stated in our earlier letter, State Street is at your disposal to discuss any of these matters with the Working Group, and to participate on its expert advisory group.

Sincerely,
State Street Bank GmbH



Stefan Gmuer



Yoram Matalon

Cc: Mr Tommaso Padoa-Schioppa
Mrs Gertrude Tumpel-Gugerell
Executive Board and Governing Council
European Central Bank