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The Committee for European
Securities Regulators and the
European System of Central Banks

Attention:
Elias Kazarian
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To the Committee of European Securities Regulators and the European System of Central Banks

UBS is grateful for the opportunity to contribute to the consultation on the Standards for Securities Clearing and Settlement Systems in the EU. This response comments on both the proposed Scope of Application and the specific Standards. We have particular concerns about the proposed scope of institutions to be covered and about Standard 9.

The Scope of Application

In responding to the issues posed in this part of the paper it is worth emphasising that the creation of central counterparties (CCP) has dramatically improved the financial stability of clearing and settlement. The market has supported this development despite increases in overall clearing and settlement costs. This is because securities trades flowing through a CCP become low risk regardless of the institutions engaged in the trades. It follows that Standards should focus, in this situation, on the CCPs themselves, rather than their users. The users' risks are already fully taken into account in setting their regulatory capital requirements, in order to maintain the necessary confidence of counterparties and the public alike.

The original CPSS / IOSCO recommendations were rightly targeted at "utility" and "utility-like" entities involved in clearing and settlement in order to set globally comparable benchmarks in the evolving cross-border activities in the financial markets. A comprehensive extension of these benchmarks to banks, who traditionally have been engaged in domestic and cross-border activities and subject to prudent banking risk considerations, would be excessive.

If the Committee decides nonetheless that "systemically important" is a definition it wishes to pursue, we would propose a definition considering the value of non-CCP business as a percentage of total market turnover. This follows from the considerations set out above. For example, if the total European market value was EUR 100 billion and the value flowing through CCPs was EUR 90 billion, then institutions providing relevant services to the remaining EUR 10 billion should be the focus. An institution that, for instance, represented

EUR 5 billion of the non-CCP business would be systemically important (i.e. 5% of the total market turnover, but 50% of non-CCP business). If it failed, there would be no central counterparty to minimise the risk rippling across the market.

Furthermore, we do not see why, in these circumstances, there should be differing standards for smaller institutions within the “functional” approach. To do so would increase the fragmentation of the market and hence load additional cost onto the end clients. Applying the Standards to all reduces regulatory complexity, allowing freed regulatory resources to be used more effectively.

Our responses and comments on the individual “issues” flow from these overall considerations.

We have already noted that CCPs provide a critical risk-reduction role in the market. They must be well managed and controlled. CSDs also provide an important function in the securities market as they provide the infrastructure for settling domestic securities. The clearing and settlement providers are already regulated and supervised and therefore should not be included in answer to **Issue 1**. It is difficult to see a net benefit from including the clearing and settlement providers. If they were included, then all providers should be included, regardless of whether they are regarded as systemically important. If the regulators want to use a “systemically important” definition then we believe the one proposed above is the most accurate way of identifying those institutions who pose the most risk to the financial markets.

In answer to **Issue 2**, all custodians should be included. All firms should compete on a level regulatory field. The alternative would lead to a fragmentation, rather than harmonisation, within the European financial market.

In response to which criteria should be used for defining systemically important institutions (**Issue 3**), UBS considers the type of trade flow as critical. We strongly suggest systemically important institutions as those responsible for a high proportion of non-CCP trade volume, relative to the total market turnover.

On **Issue 4**, we oppose the definition using purely trade value. The reason is explained above. Regulators need to consider the type of trade flow (CCP or non-CCP), rather than just consider an absolute percentage of trades.

UBS believes all products (bonds, equities and derivatives) should be considered on **Issue 5**. Those products flowing through a CCP infrastructure are already adequately risk managed as long as the CCP is correctly controlled.

All the Standards cover important areas for custodians (**Issue 6**). UBS feels some of the Standards need further focus, especially Standard 9. The Standards should apply to all custodians or none. These considerations are set out more fully below.

UBS believes, in response to **Issue 7**, that extending the regulations to include the securities clearing and settlement services of banks would needlessly duplicate regulations and costs. Such institutions are already regulated. They are already required to post capital in relation to their credit exposure. As part of Basel 2, they will also be required to capitalise their operational risk as well. The regulations covering these institutions are already in line with the objectives of CESR/ESCB. Extending the scope of institution included would only raise the cost of business for service providers and end clients.

Our particular thoughts about Standards 13, 14, 15 and 17 are detailed below. We have mentioned above our concerns about the application of Standards to select custodians. In answer to **Issue 8** therefore we believe Standards 13, 14, 15 and 17 should not be applied only to dominant custodians. They should be applied to all custodians. In applying only to dominant custodians the result could be a two tier financial market, far from the ideal of a harmonised EU environment.

The Standards

In relation to the Standards, Standard 1 requires further clarification on the scope of potential legislation. Paragraphs 33 and 34 suggest that settlement systems based outside the EU may be unsuitable due to the jurisdiction in which they reside. This would seem to be against business continuity initiatives, where servers are based across the globe to minimise the impact of any disaster scenario. These initiatives help improve the stability of the financial markets. By defining the location of the primary asset ledger in this way, the implementation of this Standard may conflict with the technical complexity, realities and the underlying regulatory objectives.

UBS continues to fully support the sentiment of Standard 2, as we did with the GSTPA. Our specific preference is for a move towards T+2 settlement. This will align securities settlement with currency markets and still allow sufficient time for foreign investors, in different time zones, to manage their execution and settlement flow. Our support does not extend to a requirement for the pre-funding of settlement.

UBS supports Standards 3 and 8, specifically paragraphs 46 and 98. These moves should lower operational risk and agent fees, while increasing intra-day liquidity.

UBS supports Standard 5 on the basis that centralised tri-party lending facilities are offered as a last resort by depositories (paragraph 69). Centrally coordinated lending has been typically expensive to use in comparison to bilateral lending. This Standard should promote bilateral or tri-party securities lending across all of Europe and so minimise delivery failures. The Standard should still allow institutions to exercise commercial judgement on the types of clients served.

Standard 6 is also supported by UBS. We acknowledge the Committee's concerns in paragraph 85 regarding vertical integration. We feel there are real concerns that vertical integration could allow cross subsidy, lower transparency and potentially higher fees. Separate entities would address these concerns.

Standard 7 is a positive move. UBS would promote an overall model of netting via the CCP, to reduce risk prior to settlement. The final net positions should then be settled with true simultaneous delivery versus payment.

We believe Standard 9 needs revising. The argument follows that set out above for a revised definition for systemically important institutions. Referring to paragraph 109, UBS believes that credit risk is removed by using a CCP and therefore credit exposure only relates to non-CCP business. Banks, as regulated institutions, already monitor their credit and operations risk and provide capital accordingly. To require collateral in addition would represent a double counting of risk provisions and inhibit the growth of the European financial market. UBS would like to work with CESR to understand how posting collateral will reduce a bank's capital adequacy requirements. UBS would propose a rewording of paragraph 109 to "In principle, operators should not run credit risks and, therefore, in cases where they extend

explicit credit to their participants they may need to fully collateralise their credit exposures. For commercial organisations, collateralisation can be used if prudent limits are reached..." This would acknowledge the risk measures already in place. If the risk limits were exceeded, a firm would be given the option to collateralise open positions.

Standard 11 offers a confusing proposal in paragraph 133. If an institution wanted to change its custodian and both parties were regulated institutions, it is difficult to see why further approval by relevant competent authorities should be required. If both parties are "fit and proper" then the regulators have already done their due diligence. UBS would have difficulty in supporting this Standard as it is currently worded.

The protection of customers' securities in Standard 12 is fully supported by UBS. It is important that other methods to protect client assets, besides "physical" account segregation are acknowledged. Standard 12 does this.

Standard 13 concerning governance is supported by UBS. Institutions both private and public, which provide key services for securities clearing and settlement, should find a balance between the objectives of owners and users.

If the Standards are to include systemically important commercial institutions, then Standard 14 and 17 may need to be reworded. The private sector firms should be free to decide their client base on a variety of criteria. They can then set prices based on their appetites for particular clients and business (Standard 17). Accepting clients of any credit worthiness would lead to an increase in overall credit risk in financial markets.

Standard 15, especially paragraph 165, is supported by UBS. Given the current consolidation of infrastructure providers in Europe, UBS welcomes the approach of the competition authorities throughout the value chain. The key theme of the Standard seems to promote more cross-market efficiency without restricting how the market achieves this.

UBS supports Standard 16 and the initiative towards harmonising communication and messaging standards. ISO 15022 (paragraph 173) should lead to a consistent and consolidated messaging interface for the market.

Standard 17, as it applies to market infrastructure providers, or "utilities" makes sense. All their participants should be provided with suitable information to understand the risks involved in a transaction. For commercial institutions focusing on complete cost transparency would be misleading and result in less competition as the number and range of institutions reduce. The few remaining providers would be able to exploit this monopoly power at the long-term cost to the client. Focusing purely on price is neither necessarily meaningful nor beneficial for end clients, which have diverse requirements.

Standard 18 and the home country principle (paragraph 198) are supported. UBS welcomes a concerted effort to minimise the number of regulatory bodies a pan-European institution has to deal with. We believe that this will require the complete support of all of the domestic regulators to result in a noticeable improvement. We would welcome any efforts by CESR/ESCB to standardise the reporting requirement and to maintain the requirements for a period of time.

We hope this provides some useful feedback to the draft Standards. UBS would welcome the opportunity to discuss these Standards further. Please contact Colin Parry in this regard. His contact details are on page 1 of this letter.

Your Sincerely

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