



**VERBAND DER AUSLANDSBANKEN IN DEUTSCHLAND E. V.**  
**ASSOCIATION OF FOREIGN BANKS IN GERMANY**

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INTERESSENVERTRETUNG AUSLÄNDISCHER BANKEN, KAPITALANLAGEGESELLSCHAFTEN, FINANZDIENSTLEISTUNGSPRÄSTANTIEN UND REPRÄSENTANZEN  
REPRESENTATION OF INTERESTS OF FOREIGN BANKS, INVESTMENT MANAGEMENT COMPANIES, FINANCIAL SERVICES INSTITUTIONS AND REPRESENTATIVE OFFICES

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CESR and ESCB Secretariat  
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September 30, 2003\ME

**Comments on the CESR-ESCB Draft Standards on Clearing & Settlement**

Dear Mr Moeliker,  
Dear Mr Kazarian,

We would like to thank you for the possibility to comment on the ESCB-CESR Draft Standards on Clearing & Settlement.

As you can see from our letter-head, the Association of Foreign Banks in Germany represents the interests of foreign banks, investment management companies, financial services institutions and representative offices in Germany. Members of the Association of Foreign Banks in Germany serve a diverse base of financial intermediaries and investors, not only institutions active within Germany but also those which have significant interest in investment and securities services across the European Union. A list of the Association's members is attached.

The Standards for securities clearing and settlement systems in the European Union proposed by the CESR-ESCB working group aim to reduce risk in clearing and settlement of securities in the EU. The Association fully supports this objective but makes the following proposal:

**Proposal:**

**The Standards should not apply the concepts of "systematically important systems" and "dominant provider" relative to custodians for any of the purposes alluded to in the Standards and should not be addressed to custodians engaged in settlement of client transactions in the EU.**

The proposed Standards intend to cover both infrastructures (central securities depositories and central counterparties) and custodian banks. Where a custodian processes a large volume of settlements relative to the total size of the relevant market, the Standards propose to regulate them in the same way as infrastructures.



Infrastructures serve the entire market and custodians offer services in a highly competitive environment. They also have different legal status, which result in different risks. To attempt to regulate custodians the same way as infrastructures is inappropriate, because both the functions and the nature of risks are different.

It should be noticed that infrastructures belong to the field of Services of General Economic Interest. As a result, they should be ring-fenced against systemic and financial risk, and prevented from using their dominant position to spoil the competitive domain. Distortion of competition could occur because infrastructures enjoy privileges in their relationships with market regulators, market authorities and other market infrastructures, which are not available to commercial enterprises.

Furthermore, infrastructures were designed to service the entire market place and benefit from an incumbent situation which no competitor can possibly match. This position, combined with market knowledge, as well as tuning of the infrastructure and bundling strategies, can be used with great effect to sell the CSD and ICSD intermediary services.

It is worthwhile noting that non-custodian market players of a significant size could also be considered "systemically important", whether they are accessing the infrastructures directly or through an intermediary. The Standards are silent on this point.

The Association agrees that the effects of systemic risks are undesirable and such risks should be appropriately regulated. However, infrastructures serve the entire market and custodians offer services in a highly competitive environment. They also have different legal status which results in different risks. To attempt to regulate custodians the same way as infrastructures is inappropriate, because both the functions and the nature of risks are different.

Custodian banks are already regulated in respect of all material aspects of their business which can give rise to internally-generated failure of their settlement functions (e.g. failure of systems or credit risk management). In addition, custodians will in due course have to comply with regulatory capital requirements in respect of operational risk under the Basel II proposals, which cover potential impacts on payment and securities systems.

Other factors which may influence systemic risk are of external origin and thus outside the control of the custodian bank. These factors are principally concerned with the effect of insolvency proceedings of a market participant, which can have seriously disruptive effects on settlement finality and certainty of contractual arrangements. Additional regulation would not reduce these external risks.

By contrast, the main operators of clearing and settlement systems (CCPs and CSDs) are not subject to any uniform EU-wide regulatory standards, and such standards for these infrastructures would be desirable. The Association considers that the new Standards should be applied in the first place to operators of such infrastructures - where there is currently no regulatory benchmark. This is consistent with the CPSS IOSCO recommendations on which the Standards are based. Historically, CSDs have not been entitled to take credit risk because of their core market function and this remains a worldwide practice.

Only where systemic issues related to custodians are demonstrably not adequately addressed by their existing regulatory system should additional regulations be considered and these should be within their existing regulatory system.

Classifying a custodian as "systemically important" might have the competitive implications of pronouncing it as, effectively, "too big to fail". In addition, the significant cost of compliance with the Standards could lead smaller custodians to exit the business, leading to increased concentration of risk

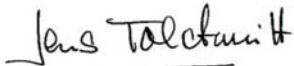



and reduced competition. These are the unintended but probable consequences if the proposed Standards are enforced.

In general the use of the Standards report and concepts relating to "systemically important systems" and "dominant provider" should not be employed relative to custodians for any of the purposes alluded to in the Standards. Virtually all Standards should be addressed exclusively to CSDs, ICSDs, and CCPs and not to custodians engaged in settlement of client transactions in the EU.

We regret that we are not able to participate at the CESR-ESCB hearing on October 2, 2003 in Paris but we would be very grateful if you could supply us with the relevant information on the results of the meeting and the further steps to be taken in this matter.

Yours sincerely

  
(Jens Tolckmitt)

  
(Markus Erb)

**Enclosure**

Members of the Association