

The CESR secretariat

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VPS response to the ESCB/CESR consultative report on Standards for Securities and Settlement Systems in the European Union

VPS welcomes the publication of the ESCB/CESR Consultative Report: “Standards for Securities Clearing and Settlement Systems in the European Union”. VPS will however initially mention our concern for the increasingly growing number of standards and recommendations imposed on the CSD’s. For a relatively small CSD such as VPS the different declarations and self-evaluations connected to the different standards occupies much resources that is needed on other fields of our operations. We will therefore point out the importance of that the standards are drafted in such way that they to the greatest extend possible can replace, or at least are coherent with, existing standards and recommendations.

Our comments are divided into two parts. The first part contains our comments to the questions raised in the additional paper “The Scope of application of the ESCB-CESR standards” issued by ESCB/CESR. The second part is our comments to the standards.

I. THE SCOPE OF THE STANDARDS

Should the extension be to all custodians, or should it be limited to systemically important providers of securities clearing and settlement services?

In order to address the relevant risks of clearing and settlement, VPS believes that it is essential that the ESCB/CESR standards applies to all entities that provide securities clearing and settlement services, regardless of which label is put on the institutions providing such services. However, the standards only need to apply to institutions posing a significant risk to the functioning of the financial markets either domestically or on a cross-border basis.

What are the criteria along which the systemically important system could be defined? What would you consider to be the essential elements that should be apart of such a definition?

VPS believes that systemically important systems should be defined along the criteria set out the ESCB/CESR paper (magnitude of the activities, number of linked systems,

nature of number of the custodians clients, the possibility of being replaced in the case of failure). However, the exact definition of the criteria, and the weighting of them, should be left to the discretion of national regulators.

Do you agree that systemically important providers could be defined as institutions with a business share of [5%] at EU level or [25%] at domestic level (or lower, at the discretion of the national authorities) in each relevant market?

VPS believes that the thresholds set out in the paper should be guiding, but not binding, for a concrete judgment made by the national regulators.

Do you agree that three relevant markets can be considered – bonds, equities and derivatives?

VPS believes that it should be possible to apply a consistent policy across all securities markets.

Which of the ESCB/CESR standards should apply to all systemically custodians?

- Standard 1 – a sound legal framework is essential for all providers of services to end – clients, not just systemically important institutions.
- Standard 2 – as the provider of services to end-clients, custodians are in a position to influence the timeliness of their clients confirming trades, and to facilitate central matching of market bargains.
- Standard 3 – custodians should clearly have to manage any move to shorter settlement cycles.
- Standard 5 – custodians should ensure that their arrangements for securities lending are sound, safe and efficient.
- Standard 9 – custodians should employ robust risk mitigation measures when extending credit for settlement purposes. While full collateralisation may be the preferable way for addressing counterparty risks, the ESCB-CESR standards should also consider additional measures to manage those risks when full collateralisation is not possible.
- Standard 10 – custodians should take steps to protect their customers from potential losses and liquidity pressures arising from the failure of the cash settlement agent (usually the custodian itself).
- Standard 11 – VPS believes that operational risks are the greatest threat to systemic stability, and that systemically important custodians should also meet the same robust

standards as employed by CSDs and ICSDs. Basle II does not cover the specific risks which are involved in clearing and settlement.

- Standard 12 – Systemically important custodians should protect customers’ securities against the claims of entities in the custody chain
- Standard 16 – VPS believes that this standard should be explicitly applied to all systemically important custodians.

What would be the implications of extending the scope of the standards to cover systemically important providers of securities clearing and settlement services?

VPS believes that, if applied and implemented consistently and simultaneously across all providers of systemically important settlement services, the implications of extending the standards will be:

- a reduction in systemic risk across European markets;
- a higher level of transparency across all such providers of settlement services; and
- a consistent and level regulatory playing field.

II. COMMENTS TO SOME OF THE PROPOSED STANDARDS

Standard 1 Legal framework

In regard to standard 1 VPS is concerned if “analysis or opinion” as mentioned in paragraph 29 is meant to be interpreted as an independent legal opinion. If so, we would urge ESCB-CESR to reconsider this and to permit in-house legal opinions.

Further, it should be noted that the recommendation that the law governing the system and the law governing the contractual aspect of the relationship with participants should be identical, appears contrary to the possibility of the free choice of the law governing a contract that is expressly provided by the Rome Convention and also recognized by The Hague Convention.

Standard 4 CCPs

VPS recommends that ESCB awaits the publication of the forthcoming CPSS-IOSCO standards on CCPs before reviewing this standard

Standard 6 Central Securities Depositories

The request to avoid taking risk to the greatest possible extent may not be achievable or desirable since all CSDs in order to provide even core services are exposed to operational risk, and to an element of custody and legal risk in the cross-border services which they offer their customers. Regulators should be vigilant that the risks taken are commensurate with the



management expertise of, and the capital held by the CSD, but they should not seek to exclude risk.

VPS will also like to stress that the content of the term “non core business” widely varies from jurisdiction to jurisdiction. An attempt to define a pan-European definition of “non core business” could have severe impact on established, well functioning systems in many markets.

Standard 11 Operational reliability

VPS believes that it is of fundamental importance for a consistent stability of the securities infrastructure that this standard is applied to all providers of clearing and settlement services. We will in this regard point to the fact that Basel II does not cover systemic risks from the settlement process, but focuses on operational risks and the capital required to support them. It is therefore essential that this standard also applies to systemically important custodian banks.

Standard 12 Protection of customer's securities

VPS believes that client's assets should always be segregated from proprietary assets, but will point out that a request to segregate upstream throughout a custody chain may run contrary to the PRIMA principle as adopted in the Hague convention. In a relayed link securities are held with the Issuer CSD for Middle CSD who in turn maintains a securities account for the investor CSD. Requiring segregation on the level of the Issuer CSD between holdings of the investor CSD and the Middle CSD would be in contradiction with the principle that the law applicable to proprietary aspects of securities holdings is the law of the relevant intermediary.

Standard 14 Access

VPS believes that this standard should permit denial of access on legitimate commercial grounds. This would also be consistent with Art. 32 of the Investment services Directive.

Standard 19 Risk Controls in cross system links

In our opinion cross-system links should be subject to the same standards as domestic settlement. The standard therefore seems superfluous.

Yours sincerely

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