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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 welcomes the revised draft of May 2004 of the proposed Standards for Securities Clearing and Settlement Systems in the EU, and the account which has been taken of our earlier comments. We are grateful for the opportunity to contribute further to the consultation. This response comments on both the proposed Nature of the Standards and the specific Standards. Hereafter the Committee of European Securities Regulators and the European System of Central Banks will be referred to as the Committee.

The Nature of the Standards

UBS remains concerned that the inclusion of "systemically important" custodians will lead to a two-tier custodian market. It is not clear that those custodians who clear and settle a large volume of securities represent a disproportionate risk to the market, given practical regulation is already in place. Since the draft Standards pass the responsibility for the classification of systemically important custodians and collateral obligations onto the local regulators, it would be helpful if the classification and subsequent calculation of collateral requirement were as transparent as possible.

UBS also supports the recognition of Basel II as covering the risk exposure of custodians through the application of capital adequacy requirements. If custodians are regarded as holding additional risks then risk mitigation measures should apply to all rather than a select few.

The Standards

In relation to the Standards, Standard 2 recommends timely confirmation and settlement matching of trades, and encourages the automation of this process. UBS supports this standard.

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In Standard 4, UBS supports the use of CCPs. As more markets move across to using a CCP, they should be encouraged to use existing providers. The CCP infrastructure should be re-used rather than duplicated at the expense of the users. The LCH.Clearnet merger once completed could provide a suitable example.

UBS supports Standard 5 on the basis that centralised agency lending facilities are offered as a last resort by depositories. 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.

The Standard states that in no case can debit balances nor the creation of securities be allowed. This statement requires further clarification, specifically whether the creation of debit balances should be prohibited at the CSD, agent, or client level, and whether the statement is regarding cash or stock balances. For the smooth functioning of markets, for example in relation to stock splits, debit balances should be allowed.

Standard 6, as currently drafted, seems inconsistent. CSDs need to be able to offer CCP services as part of the current market model. It is not inappropriate for them to take on risk in so doing, as the draft implies: after all, risk taking is an integral part of securities borrowing and lending, which the Standard would allow (page 31 paragraph 72, page 34 paragraph 79). So some revision is required.

Standard 7 and 12 require refinement. DvP for custodians on the client side is not practicable (page 34 key element 4, page 59 paragraph 7). This is due to our understanding of DvP being based upon finality only occurring at the CSD.

An integral component of efficient and orderly markets is the ability of retail franchises and prime brokers to provide their clients with contractual settlement. Through the process of contractual settlement, settlement risk is transferred from the clients and placed into the hands of market professionals. As a result of this process, client accounts can certainly run credit or debit balances of cash or stock. It is the responsibility of the bank/broker to manage their overall stock and cash balances, and ensure that any debit stock balances are covered via securities lending transactions. The Standards should encourage the continued use of contractual settlement by banks/brokerages to their clients, and therefore the management of settlement risk by market professionals.

For DvP on the “market” side, the Committee should facilitate cross border transaction by gaining agreement on a single DvP model (page 37, paragraph 87). If each country has its own DvP variant then cross border harmonisation will not be achieved and costs will remain high.

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, such as custodians, focusing on complete cost and risk transparency would be misleading and result in less competition as the number and range of institutions reduce (page 76, paragraph 189). 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 (page 80, paragraph 199) 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 the Committee 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.

Yours sincerely

Colin Parry
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