



EUROPEAN CENTRAL BANK

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## SUMMARY OF RESPONSES ON THE EUROPEAN SYSTEM OF CENTRAL BANKS (ESCB) AND COMMITTEE OF EUROPEAN SECURITIES REGULATORS (CESR) JOINT CONSULTATION ON STANDARDS FOR SECURITIES CLEARING & SETTLEMENT SYSTEMS IN THE EUROPEAN UNION

*This summary of the responses to the public consultation on Standards for Securities Clearing & Settlement Systems in the European Union does not constitute a complete overview of all the opinions expressed by respondents. It has been drafted on a 'best-efforts' basis and only highlights some of the more significant points made by the respondents. For further details the full submissions which are annexed to the present summary may be consulted. Neither the summary nor the submissions reflect the position of the ESCB-CESR Working Group or its constituent members on the various issues.*

This note summarises the responses to the ESCB-CESR public consultation on the consultative report entitled 'Standards for securities clearing and settlement systems in the European Union' and the note entitled 'Scope of application of the ESCB-CESR standards'. The ECB and CESR received 55 contributions from representatives of custodian banks, domestic central securities depositories (CSDs) and international central securities depositories (ICSDs), central counterparties (CCPs), stock exchanges and various associations market players. The list of contributors and their full submissions are annexed to this summary.

This note is structured as follows. The first part summarises the general comments, while the second part summarises the observations on individual standards.

### **1. GENERAL ISSUES**

All responses express strong support for the central banks' and CESR's initiative of having common rules in order to promote the safety and efficiency of clearing and settlement activities in the European Union (EU). In addition, some responses welcome the fact that the ESCB-CESR standards are based on the recommendations of the Committee on Payment and Settlement Systems of the central banks of the Group of Ten countries (CPSS) and the International Organization of Securities Commissions (IOSCO) thus facilitating greater mutual recognition and promoting overall reliability in financial markets at the global level. However, concerns were voiced regarding the extent to which this

initiative would duplicate the work of other initiatives. In this respect several of the respondents called for harmonisation of the various legislative, regulatory and industry initiatives, especially as regards reporting requirements and operational standards.

***The objectives of the standards.*** Although the ESCB-CESR objective of applying the functional approach to regulation is broadly endorsed by the respondents, their interpretations of the functions differ significantly. Some respondents argue that function should be defined in terms of ‘infrastructure’ and ‘intermediary’, while others indicate that each segment of the value chain of a securities transaction should be considered as a separate function.

Some respondents hold the view that competition issues should be left completely outside the scope of ESCB-CESR work and be handled by the relevant national regulators and EU institutions. One respondent argues that some of the proposed standards are of a highly political nature, particularly those addressed to custodians. For example, it is stated that the ESCB-CESR cannot unilaterally impose a full collateralisation requirement on custodian banks, this needs to be discussed and decided upon by the European Institutions (i.e. Commission, Council and Parliament). Furthermore, it is argued that the proposal to define a new category of ‘dominant custodians’ and regulate them raises important competition issues and therefore should be addressed by appropriate EU competition policy authorities, perhaps in consultation with ESCB-CESR.

Finally, one response underlines that the objective of fostering the protection of (retail) investors is not met by the standards, as they do not cover all risks to which investors are exposed when investing in local capital markets. The respondent was of the view that the standards are in practice essentially directed at wholesale market participants.

Finally, in line with the objectives of ESCB-CESR work, and especially those of harmonising the regulatory and supervisory framework across the EU, building confidence in the markets by regulation, fostering the protection of investors and integrating EU markets by integrating standards, several respondents expressed the view that many of the standards should be addressed to competent national supervisory competent authorities or NCBS who are in a position to instigate legislative and regulatory changes.

***The nature of the standards.*** Changing the nature of the standards from non-binding recommendations to more binding standards is generally endorsed. Nevertheless, some respondents express a preference for recommendations and market-led solutions for certain items such as those related to efficiency. However, one contribution raises a concern that changing the nature of the CPSS-IOSCO recommendations to ‘soft’ law based on the functional approach may not be in line with the existing set of European ‘hard’ laws, which follow an institutionally related supervisory approach. One response states that it would be helpful to distinguish between those standards which should be implemented as ‘best practice’ and those which are ‘strict requirements’ and to incorporate such a distinction into the formal regulatory regime applicable to the relevant entities. A proposal is made as to which standards should be considered as best practice or as strict requirements. Several respondents

went further, suggesting that a selection of ESCB-CESR standards should form the basis of EU legislation, thus ensuring consistent application across EU markets.

**Relation to other initiatives.** Two respondents emphasise the need for consistency and compatibility between ESCB-CESR work and other initiatives, including the work of the Commission and private sector recommendations, in order to avoid duplication and over-regulation. Examples of such initiatives cited are the Giovannini Reports, the draft Investment Services Directive, the Banking Directives, the CPSS-IOSCO standards for CCPs and the European Association of Central Counterparty Clearing Houses (EACH) standards. Many contributions note that the ESCB-CESR standards, when adopted, should replace other standards in the same area in order to avoid confusion and duplication. They refer in particular to the CPSS-IOSCO disclosure framework of 1997, the CPSS-IOSCO recommendations of 2001 and the Eurosystem Standards of 1998 for the use of EU securities settlement systems in Eurosystem credit operations. One response raises concerns that the proposed standards may affect the EU consolidation process. Finally, one respondent requests a delay in implementing the standards, until the outcome of the European Commission's current activities in this field is clear.

**Implementation of the standards.** A few respondents refer to the lack of clarity with regard to the procedures and timing of the implementation. For example, one respondent asks whether the application of the standards will be assessed in a public or confidential form. Certain respondents advocate a relatively high degree of publicity. In order to avoid regulatory and supervisory arbitrage, one contribution suggests agreeing upon a schedule for implementation and reporting on progress. Another response is in favour of early and speedy implementation of the standards at national level. Furthermore, it is seen as important that ESCB-CESR ensure sufficient monitoring and transparency of the actual implementation of the standards. It is noted that the draft standards leave room for issues like 'passporting' and 'mutual recognition' which should be part of the total 'package'. Furthermore, in order to reach the objective of mutual recognition it is proposed that ESCB-CESR work should be composed of three blocks: 1) the ESCB-CESR standards; 2) a 'national' evaluation of whether the standards are met; and 3) a 'supra-national' evaluation exercise to reinforce mutual confidence. One contribution calls for uniform interpretation and states that no room should be left for additional national input. Finally, one response urges ESCB-CESR to work with their US counterparts to establish the new standards as the main assessment framework for European institutions from the US perspective too.

## **SCOPE OF APPLICATION**

The reactions concerning the scope of application of the standards can easily be grouped into two clearly defined positions: the banks and their relevant associations strongly oppose the proposal to include custodian banks within the scope of the standards, whereas the (I)CSDs, some stock exchanges and securities dealers associations strongly favour extending the scope to cover all systemically

important entities, including custodian banks. The main arguments in favour or against the proposed scope of application can be summarised as follows.

**The banking community** argues that a distinction should be made between infrastructure and intermediaries. In particular, (I)CSDs are considered to be infrastructures responsible for the ultimate change of ownership when transfers of securities occur, while custodian banks as intermediaries cannot offer finality of ownership transfers.

Second, it is pointed out that the systemic risks associated with the operations of (I)CSDs are different in kind and degree from the type of risks associated with the 'typical settlement-related' activities of custodian banks. In their views, (I)CSDs as infrastructure are responsible for administering and managing the aggregate settlements for the entire community of participating intermediaries. In contrast, custodian banks facilitate settlements for each of their clients on an agency basis. If an (I)CSD malfunctions, it will affect all the participant intermediaries, while if a custodian bank malfunctions the effect will be relatively limited as the ability of the market as a whole to continue operating will not be jeopardised. Settlement activities undertaken by custodian banks on their books should not give rise to greater systemic risk concerns than other activities undertaken by banks. Many of the respondents regard it as obvious that standards for settlement infrastructures need to be developed, which ultimately record the ownership of securities (at CSD level). It is pointed out that despite the systemic importance of CSDs, no EU-wide regulation exists today. On the other hand, there is a concerted opposition to applying the current drafting of Standard 9 to custodians. The use of collateralisation as a way of reducing credit risk differs from the normal measures currently used by banks to manage their credit exposures. Banks argue in favour of recognising the acceptability of the risk mitigating measures that they currently employ, whereas (I)CSDs argue in favour of alternatives being acceptable only if full collateralisation is impossible.

Third, as already noted above, the banking community points out that the CSDs are currently not subject to European regulation, while custodian banks are already subject to comprehensive banking regulations both at the national and European level (e.g. under the Banking Consolidation Directive). They are subject to stringent monitoring and undergo frequent audits and supervisory examinations. For this reason it is considered neither necessary nor appropriate to over-regulate the banking industry by subjecting them to another set of standards.

Fourth, the banking community rejects the ESCB-CESR's approach of equating CSDs, ICSDs and custodian banks on the ground of market infrastructure. (I)CSDs operate *de facto* in a monopoly situation, i.e. a 'public utility' function, while custodian banks compete among themselves. It is suggested that the regulators should recognise this situation when defining rules, in particular where they relate to efficiency, transparency, governance and access.

Some respondents recognise that the need to define a systemically important custodian may only arise when dealing with operational risk, as was the case for the G30 recommendations. However, they oppose using the US example of 'sizeable intermediaries and custodians', as described in the US Interagency Paper, in order to extend all ESCB-CESR standards to custodian banks. One respondent

proposes applying the standards to those custodian banks that provide services comparable to CSDs both in quality and size, but disagrees with the concept of a systemically important system for the purpose of extending the standards to custodian banks.

The majority of the banking community opposes the idea of allowing CSDs to assume principal risks because this function is not essential to their function as an infrastructure provider. One response advocates using the banking regulation framework to regulate the securities and cash-lending activities of CSDs in a similar way to the prudential regulation applied to banks or investment firms. In the case of the ICSDs, some respondents argue that the ICSDs are 'mixed-function entities', i.e. for eurobonds they combine the functions of both CSD and intermediary. In their view, these two functions should be 'ring-fenced' and different regulatory requirements should apply to the different functions. In particular, they support applying a banking risk-based regulatory approach to the intermediary functions and the ESCB-CESR standards for the CSD functions. This approach should also be applied to those CSDs that offer securities and cash-lending facilities.

***The (I)CSDs and stock exchanges community*** endorse the extension of the standards to all systemically important systems, including CSDs, ICSDs, CCPs and custodian banks. They argue that, in reality, there is no difference between the settlement taking place at the level of the (I)CSDs or at the level of custodian banks. The settlement of German government bonds was given as an illustrative example that can be performed both at the level of the CSD and at that of custodians. Even if all German domestic bonds are held in final custody by Clearstream Banking Frankfurt (CBF), in its capacity as CSD, the majority of transactions are executed and settled at the intermediary level without needing to alter CBF's records. In the view of many European countries, the notary function is not exclusive to CSDs and nothing prevents custodian banks from assuming such a function. For this reason, they argue that regulating (I)CSDs, while excluding custodian banks providing the same services from the scope of the standards, would not achieve the goals of enhancing safety, soundness and efficiency, and promoting a level playing field and harmonisation in the EU.

The (I)CSDs and stock exchanges community stress that any differences in the regulatory environment between (I)CSDs and custodian banks would incentivise a shift of settlement activities from (I)CSDs to custodian banks. However, one CSD is of the view that core services must be regulated separately from value-added services. Opinions also differ as to whether all providers or only systemically important ones should be subject to the standards. In this context, some respondents stress the need only to cover custodian banks that are important at the European level, while custodians with domestically-oriented activities should be excluded. They consider that the risks are arguably more localised and appropriate coordination between national regulators on their application of rules may be sufficient.

Second, they point out that the current banking regulatory framework does not address the risks deriving from clearing and settlement such as custody risk, intraday exposures and operational risks, while the ESCB-CESR standards deal with the overall market stability and efficiency based on the specific features of clearing and settlement functions. As an example, they indicate that the new Basel II approach to handling operational risks is related to the size of the capital adequacy of the entity and

not specifically to the risk associated with clearing and settlement, which may affect the entire financial sector.

One response considers that the standards should also be applied to institutions acting as general clearing members and credit institutions acting as payment agents for participants in settling the cash leg.

With regard to the role and function of CSDs, several contributions from the (I)CSDs and stock exchanges community question the proposal by the ESCB-CESR to limit the functions of the CSDs as it would have potentially serious and detrimental effects on the business of CSDs in Europe. In their view, it is neither practicable nor desirable to try to define CSDs or settlement systems by way of restrictions. In particular, they refer to Standard 6 on CSDs, which asks them to avoid taking risk to the greatest practicable extent. It is argued that CSDs today already assume different kinds of risk and in particular for cross-border activities. As an alternative, they propose that the standards should be rephrased to reflect the CSD's role in managing or mitigating the risks.

Finally, some respondents argue that the standards should also be addressed to other bodies such as national central banks (NCBs), regulators and stock exchanges. For instance, for the removal of legal and fiscal barriers, Standard 5 on securities lending should be addressed to national regulators and legislators too. Standard 8 on Intraday Finality and Standard 10 on Cash Settlement Asset should also be extended to NCBs. In their view, many central banks offer only one batch a day for the settlement of cash leg, which is insufficient to allow intraday finality.

***Measures to define systemically important custodians.*** Those respondents in favour of applying the ESCB-CESR standards to systemically important custodians propose some quantitative measurements, while the banking community, which is against such a proposal, generally preferred to remain silent on this subject.

On this subject, one response opposes the use of thresholds, as customers would be given an incentive to move away from custodian banks, which are classified as systemically important, to avoid the associated costs.

With regard to criteria for identifying systemically important custodians, many respondents express the view that the ESCB-CESR has already defined the relevant criteria accurately in its note on the scope of application (magnitude of activities, number of linked systems, nature and number of the custodian's clients, the custodian's 'replacability' in the case of failure). However, many of these respondents see a difficulty in defining the 'relevant market' accurately enough to be able to determine the individual entities' settlement shares. As a quantitative measurement, a ratio of internally settled transactions to externally settled transactions for different clients is proposed. Another measurement proposed is to relate the daily average value of all gross transactions (pre-netting) processed by a custodian to the total trading value of a specific market. The daily average value could be computed over a period of at least 6 months. The threshold of 25% at domestic level is generally considered to be too high. Therefore, some respondents propose giving the national authority the choice of applying a lower percentage. The thresholds act as guidance and do not bind national

authorities. If an entity falls below the thresholds, the national authorities should be able to use additional criteria such as links with other systems, the nature and number of clients and replacability to classify an entity as systemically important.

Another response expresses doubt as to whether the ESCB-CESR should specifically focus on custodian banks that are systemically important at the European level, while leaving the regulation of such institutions at national level to national authorities.

With regard to the question of which of the ESCB-CESR standards should apply to systemically important custodians, many respondents state that all the standards are relevant except for Standards 10 on Cash settlement assets, 13 on Governance, 17 on Transparency and 19 on links. It is also proposed that Standard 9 on Risk control could be complemented by existing and future banking regulation in the event that full collateralisation is not possible.

***Custodian with a dominant position.*** A large majority of the respondents do not see a need to define a new category of ‘custodians with a dominate position in a specific market’, and to apply specific standards to such banks which are otherwise operating in a competitive market. They also stress that if competition can not guarantee fair access, efficient governance and transparency, these issues should be handled by the national regulators and relevant European authorities responsible for competition policy. One response believes that the introduction of a new category of ‘custodians with a dominant position’ would create confusion within existing competition law rules prohibiting the abuse of a dominant position under the EC Treaty or national legislation. Therefore, rules on Governance (Standard 13) and Access (Standard 14), Efficiency (Standard 15) and Transparency (Standard 17) seem ill-suited to agent banks. One response indicates that the ESCB-CESR can only make recommendations on such issues, leaving it to the relevant competition authorities to draft and implement regulations.

### **3. COMMENTS ON INDIVIDUAL STANDARDS**

The comments received on individual standards are summarised below. The text of the standard in *italics* does not reflect the difference between the ESCB-CESR standards and the CPSS-IOSCO recommendations.

#### **Standard 1 (Legal framework)**

*Securities clearing and settlement systems and links between them should have a well-founded, clear and transparent legal basis in the relevant jurisdiction.*

According to many respondents from the banking community, this standard should not apply to systemically important custodians, but should be addressed to legislators and regulators. The purpose and scope of this standard should be further clarified and the work envisaged by legislators should be specified.

According to many respondents from depositories, the provision of minimum information by an operator of a system to market participants on the fifteen issues, identified in the explanatory memorandum on this Standard (paragraph 29 of this standard, in conjunction with Standard 17 on transparency), are considered to be burdensome. Provision of this information should be limited to the domestic legal framework. It should also be permitted to provide them on the basis of internal analysis and not to require external legal advice. Other respondents suggest moving this paragraph to Standard 17. In the context of key-element 2, which obliges addressees to publish - *inter alia* - contractual provisions, some respondents oppose public access of negotiated terms with clients on the basis of confidentiality, but see merit in transparency regarding non-negotiable terms and conditions of infrastructure utilities like CSDs and CCPs .

### **Standard 2 (Trade confirmation and settlement matching)**

*Trades between direct market participants should be confirmed without delay after trade execution and no later than trade date (T + 0). Where confirmation of trades by indirect market participants (such as institutional investors) is required, it should occur as soon as possible after trade execution and no later than T + 0.*

*For settlement cycles that extend beyond T + 0, settlement instructions should be matched as soon as possible and no later than the day before the specified settlement date.*

According to a few respondents, the standards dealing with the procedures of settlement (Standards 2, 3 and 16) should be renamed ‘best practices’. Another respondent proposes harmonising the way in which these confirmations are referred to. Several respondents state that confirmation of trades on T + 0 will entail difficulties because of differences in messaging standards, communication protocols and time-zone differences. Investment managers may not be able to choose the broker they do business with and therefore may have little or no say in how to confirm trades. CSDs and ICSDs are not in a position to influence end-investors’ behaviour directly.

### **Standard 3 (Settlement cycles)**

*Rolling settlement should be adopted in all securities markets. Final settlement should occur no later than T + 3. The benefits and costs of EU-wide settlement cycles shorter than T + 3 should be evaluated.*

Some respondents hold the view that more clarity is needed as regards the application of this standard to securities such as derivatives and commodities. The emphasis of this standard should be on undertaking a cost/benefit analysis before taking a decision to harmonise settlement cycles. Several respondents advocate excluding OTC-transactions from the application of this standard and underline the importance of freely negotiated settlement cycles in OTC-trading. One response notes that further shortening settlement cycles could temporarily lead to a higher rate of failed trades. Some respondents believe that further study by ESCB-CESR of settlement cycles is unnecessary, duplicates other

initiatives and would entail immense costs. Harmonising settlement periods should be limited to exchange trades only and essentially to equities. Furthermore, harmonised operating hours are welcomed. It is pointed out that custodian banks should not be held responsible for adhering to settlement cycles as this issue is beyond their control.

#### **Standard 4 (CCPs)**

*The benefits and costs of a CCP should be evaluated. Where such a mechanism is introduced, the CCP should rigorously control the risks it assumes.*

According to some respondents, this standard and the extension of other standards to CCPs should be postponed until the work of the CPSS-IOSCO on CCPs is finalised. One response states that the standard should focus more on the core prudential-capital and risk-related issues if they are intended to be a basis for mutual recognition. Other respondents consider that CCPs should always be able to offer cash settlement in central bank money. As an interim step, it is suggested that CCPs with non-securities business should be designated as 'systems' under the Settlement Finality Directive.

#### **Standard 5 (Securities lending)**

*Securities lending and borrowing (or repurchase agreements and economically equivalent transactions) should be encouraged as a method for expediting the settlement of securities. Barriers that inhibit the practice of lending securities for this purpose should be removed. The arrangements for securities lending should be sound, safe and efficient.*

Several respondents hold the view that CSDs and ICSDs should be encouraged or compelled to make efficient centralised securities lending/borrowing facilities openly available for both direct and indirect participants. When offering such facilities, they should be subject to the same requirements as banks. Standards relating to risk-management, such as this, and Standards 7, 8, 9, 10, 11, 12 and 19, should be compared with existing regulations. According to some respondents, bilateral securities lending should be excluded from this standard as it is already regulated. Other respondents propose to exclude custodians from the scope of this standard for the same reason.

#### **Standard 6 (CSDs)**

*Securities should be immobilised or dematerialised and transferred by book-entry in CSDs to the greatest extent possible. To safeguard the integrity of securities issues and the interests of investors, the CSD should ensure that the issue, holding and transfer of securities are conducted in an adequate and proper manner.*

Many respondents hold the view that CSDs - as infrastructure providers - should not engage in any activity involving risk that is not essential to their core functions. Others, however, prefer to allow CSDs to offer additional services and, in this way, be better adapted to their understanding of the

functional approach. One response notes that it is impossible for a CSD to avoid taking any risks; certain risks will always remain with the CSD. Another response advocates a clear distinction between various (utility versus competition-driven services) CSD activities. Other respondents advocate addressing this standard to national regulators and legislators as well, for instance with regard to the continuation of CSD-services in the event of insolvency.

Some respondents note that listing permitted activities for CSDs in the standard contravenes the functional approach. One respondent suggests incorporating the risk impact of different holding structures (direct/indirect). Another respondent fears that this standard runs contrary to the functional approach and may have the effect of moving authority away from CSDs to regulators. Another respondent notes that, being denied direct membership of clearing bodies and settlement institutes, institutional investors mainly have to rely on services rendered by global custodians to ensure the quality of settlement.

### **Standard 7 Delivery versus payment (DVP)**

*Principal risk should be eliminated by linking securities transfers to funds transfers in a way that achieves actual delivery versus payment.*

Many respondents from the banking community favour excluding banks from the scope of this standard as they are already subject to risk mitigation banking regulation. Two respondents point out that DVP is not designed as a mechanism to protect investors against the failure of a CCP. Some respondents call for further clarification on the exact meaning of ‘delivery versus payment’ and the different degrees of DVP. Another response encourages investigation of the issue of ‘chaining’ (transactions covering both ICSDs and CSDs). One response underlines that DVP should be processed via a secure electronic system.

### **Standard 8 (Timing of settlement finality)**

*Intraday settlement finality should be provided through real-time or multiple-batch processing in order to reduce risks and allow effective settlement across systems.*

This standard should not apply to custodian banks according to many respondents from the banking community. According to a few respondents, the standard should apply to central banks with regard to the settlement of the cash leg of a transaction. Certain respondents felt that specific national regimes under the existing TARGET system should be prohibited.

### **Standard 9 (Risk controls in systemically important systems)**

*Entities that operate systemically important systems need to put in place rigorous risk control measures in order to ensure that the probability of failing to provide timely settlement is negligible. Systemically important systems that extend explicit credit to participants should employ robust risk*

*mitigation measures and, whenever practicable, full collateralisation should be applied. Incomplete collateralisation must be complemented by additional risk mitigation measures such as minimum credit quality of the borrower, credit exposure limits and, on the part of the operator, an adequate minimum capital base and adequate internal risk control measures.*

*Operators of net settlement systems should institute risk controls that, at a minimum, ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle.*

Many respondents from the banking community believed that this standard should not apply to custodian banks, due to credit-management experience, current regulation and risk monitoring systems. Many of the respondents reject full collateralisation as a risk control measure and felt that more provision should be made for the use of risk management techniques other than full collateralisation. One response proposes an amendment to the standard explicitly stating that the provision of unsecured credit by banks should be allowed.

#### **Standard 10 (Cash settlement assets)**

*Assets used to settle payment obligations arising from securities transactions should carry little or no credit or liquidity risk. If central bank money is not used, steps must be taken to protect the participants in the system from potential losses and liquidity pressures arising from the failure of the cash settlement agent whose assets are used for that purpose.*

The banking community opposes the application of this standard to custodian banks, as they are not in a position to provide their clients access to central bank money. According to some respondents, this standard should also be addressed to central banks. One response notes that the ESCB should recognise different methods for transferring central bank money claims between settlement systems. Cross-border settlement of the cash leg is one of the major obstacles to cross-border DVP. Commercial bank money however, remains a viable way of settling cross-border transactions, according to some other respondents.

#### **Standard 11 (Operational reliability)**

*Sources of operational risk arising in the clearing and settlement process should be identified, monitored and regularly assessed. This risk should be minimised through the development of appropriate systems and effective controls and procedures. Systems and related functions should be (i) reliable and secure, (ii) based on sound technical solutions, (iii) developed and maintained in accordance with proven procedures, (iv) have adequate, scalable capacity and (v) have appropriate business continuity and disaster recovery arrangements that allow for the timely recovery of operations and the completion of the settlement process.*

According to representatives from CSDs, this standard should apply to all providers of clearing and settlement services since Basel II does not cover systemic risks from the settlement perspective. One ICSD strongly supports this standard, favours a broad scope of application, promotes the application

of strict standards for business continuity plans and suggests considering existing Basel regulation on operational risk. On the other hand, banking community representatives, with a reference to current and future Basel regulation, do not support the application of this standard to custodian banks and suggest renaming this a ‘best practice recommendation’. One respondent notes that this standard is insufficiently accurate to provide true standardisation.

Another response asks for clarification of the meaning of ‘outsourcing’. Some other respondents from the banking community have strong reservations regarding prior approval by the relevant competent authorities when outsourcing clearing and settlement activities. Instead, the terms of outsourcing practice should be contractually negotiated between the outsourcer and the service provider.

According to the banking community, extending the scope of this standard to network providers is unnecessary and could be covered by separately negotiated service level agreements.

### **Standard 12 (Protection of customers’ securities)**

*Entities holding securities in custody should employ accounting practices and safekeeping procedures that fully protect customers’ securities. It is essential that customers’ securities be protected against the claims of the creditors of all entities involved in the custody chain.*

Two respondents suggest excluding custodian banks from the scope of this standard in order to avoid duplicating rules. One of these refers to Article 12 of the Investment Services Directive (ISD). To contrast, one representative organisation suggests that the scope of this standard should be broadened to all consumer interests, including customers’ money. Another response states that the scope of the standard should be explicitly limited to safekeeping only. Yet another response emphasises, in this context, the importance of clarity with regard to legal ownership of securities.

As far as segregation of assets is concerned, the standard should make it clear that the scope of segregation is between assets of the CSDs and assets belonging to clients, rather than segregation between the assets of each individual client. Segregation of client’s assets should be the rule, but the application of upstream segregation may run against the PRIMA-principle, according to some providers of CSD-services.

Two banking representatives hold the view that the standard should not be prescriptive as to the accounting method used, as this would reduce flexibility and increases costs. One of these respondents doubts whether reconciliation of holdings in a single-entry system will add value to the interests of customers.

### **Standard 13 (Governance)**

*Governance arrangements for entities providing securities clearing and settlement services should be designed to fulfil public interest requirements and to promote the objectives of users and owners.*

One response suggests rethinking the objective of this standard as it questions whether governance is an issue to be handled by standards at all. Other respondents express the views that it is for public authorities to identify and implement public policy interest and not for the private sector. One respondent notes that CSDs, CCPs and custodian banks are not primarily public law institutions with the consequence that the governance principles flow from company law. The view of the majority of the banking community is that this standard and standards on access, efficiency and transparency should only apply to CSDs and CCPs and not to custodian banks. Some respondents argue that self-regulation or recommendations are a better solution than standards.

#### **Standard 14 (Access)**

*CSDs and CCPs and custodians with a dominant position in a particular market should have objective and publicly disclosed criteria for participation that permit fair and open access. Rules and requirements that restrict access should be aimed exclusively at controlling risk.*

According to one respondent, the ESCB-CESR working group should more actively support other initiatives to remove barriers to fair and open access. Some respondents point out that there is a need for consistency between the criteria in this standard and those of Article 32 of the proposed ISD which emphasises the ‘legitimate commercial grounds’ rather than only the risk aspect of a refusal of access.

Doubts are raised with regard to the enforceability of the standards in relation to providers that offer messaging services and communication networks, as these institutions are mostly unregulated.

#### **Standard 15 (Efficiency)**

*While maintaining safe and secure operations, securities clearing and settlement systems should be cost-effective in meeting the requirements of users, including interoperability at both the national and the European level.*

Opinions among the respondents vary widely as to whether custodian banks should be covered by this standard. Some respondents believe that integration and interoperability are possible solutions for creating an efficient system. However, intervention by public authorities is just as important as efforts by CSDs, CCPs and providers of settlement services. Expanding the scope of this standard to the NCBs should also be considered in order to cover the payment leg of the settlement transaction.

#### **Standard 16 (Communication procedures)**

*Entities providing securities clearing and settlement services and participants in their systems should use or accommodate the relevant international communication procedures and messaging and reference data standards in order to facilitate efficient clearing and settlement across-system. This will promote straight-through processing across the entire securities transaction flow.*

*Service providers should move towards straight-through processing (STP) in order to help to achieve timely, safe and cost-effective securities processing, including confirmation, matching, netting, settlement and custody.*

Existing standards such as ISO 15022 should be taken into account in order to mitigate the impact of this standard. Another response states that this standard should be regarded as a best practice rather than imposed rules. According to some respondents, the decision whether to invest in increased STP will depend mainly on customer demand and available resources.

#### **Standard 17 (Transparency)**

*CSDs and CCPs and custodians with a dominant position in a particular market should provide market participants with sufficient information for them to identify and evaluate accurately the risks and costs associated with securities clearing and settlement services.*

There is wide disagreement among the banking community with regard to the application of this standard to custodian banks. Many respondents argue that an increase in thereporting burden on the industry should be avoided. Some respondents have serious concerns regarding introducing changes to the methodology for disclosing information by moving from the CPSS-IOSCO framework to an ESCB-CESR assessment methodology and urge a full consultation regarding the scope and depth of required information before any changes are made. One ICSD proposes referring to Pillar 3 of the Basel II framework with regard to disclosure framework. Other respondents believe that transparency of global custodians is more appropriately achieved through direct interaction between custodians and the relevant institutions or investors seeking their services. Two respondents suggest limiting the scope of this standard to securities infrastructures.

#### **Standard 18 (Regulation, supervision and oversight)**

*Entities providing securities clearing and settlement services should be subject to transparent, consistent and effective regulation, supervision and oversight. Central banks and securities regulators/supervisors and overseers should co-operate with each other and with other relevant authorities, both nationally and across borders (in particular within the EU), in a transparent manner.*

One response states that due to the importance of this standard, the ESCB-CESR should actively support legislative action on the part of EU authorities. Furthermore, the question of jurisdiction based on the 'European model' should be elaborated on. Entities active in several Member States should be subject to supervision by only one authority, namely the authority operating where the entity is located. Another respondent underlines the need to have a regulatory 'single-entry point'. It is also argued that in order to identify risks correctly and address them adequately, the regulators should take into account the differences between ICSDs, CSDs and global custodians in terms of functional business objectives, client profile, legal status and structure.



**Standard 19 (Risks in cross-system links)**

*CSDs that establish links to settle cross-system trades should design and operate such links to effectively reduce the risks associated with cross-system settlements.*

Some respondents from the CSD community see no merit in a separate standard on this issue, since the same rules for domestic operations should apply to links. Respondents from the banking community are of the opinion that this standard should apply only to CSDs and ICSDs.

## ANNEX: LIST OF RESPONDING ORGANISATIONS

1. ABI
2. ABN AMRO Bank N.V.
3. ABP Investments (ABP)
4. Afei
5. AFTI
6. Association of Danish Mortgage Banks (ADMB)
7. Association of Foreign Banks in Germany (AFBG) (Verband der Auslandsbanken in Deutschland)
8. Association of Global Custodians (AGC)
9. Assosim
10. Banca Intesa
11. Banco Bilbao Vizcaya Argentaria (BBVA)
12. Barclays Plc
- [13.](#) BNP Paribas
- [14.](#) Borsa Italiana Group
- [15.](#) British Bankers' Association (BBA)
- [16.](#) Bundesverband Investment und Asset Management e.V. (BVI)
- [17.](#) Cap Gemini Ernst & Young (Cap)
- [18.](#) Citigroup
- [19.](#) Deutsche Bank
- [20.](#) Deutsche Börse
- [21.](#) Deutsche WertpapierService Bank AG (dwpbank)
- [22.](#) EACH
- [23.](#) ECSDA/CEECSDA
- [24.](#) Euroclear
- [25.](#) European Association of Co-operative Banks (EACB)
- [26.](#) European Savings Banks Group (ESBG)
- [27.](#) European Security Forum (ESF)
- [28.](#) Fédération Bancaire de l'Union Européenne (FBE)
- [29.](#) Fédération Bancaire Française (FBF)
- [30.](#) Federation of European Securities Exchanges (FESE)
- [31.](#) Hellenic Bank Association (HBA)
- [32.](#) Hellenic Exchanges Group (HELEX)
- [33.](#) Hessian Ministry of Economics, Transport and Regional Development (Hess. Ministerium für Wirtschaft, Verkehr und Landesentwicklung - Börsenaufsicht) (Hessian)
- [34.](#) HEX Integrated Markets (HEX)
- [35.](#) Iberclear
- [36.](#) Investment Management Association (IMA)
- [37.](#) Kas Bank N.V. (Kas)

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- [38.](#) LCH/Clearnet
- [39.](#) London Investment Banking Association (LIBA)
- [40.](#) Nordea
- [41.](#) Nordic Custodian Banks (Nordic)
- [42.](#) Opex
- [43.](#) Santander Central Hispano (SCH)
- [44.](#) Securities Industry Association (SIA)
- 45. SIS Group
- [46.](#) State Street Bank (SSB)
- [47.](#) Swedish Bankers Association (SBA)
- [48.](#) Swedish Securities Dealers Association (SSDA)
- 49. The Central Clearing House and Depository (Keler Rt.), the Hungarian Financial Supervisory Authority (PSZÁF) and the National Bank of Hungary (Magyar Nemzeti Bank) (Hungarian Institutions).
- [50.](#) The Finnish Bankers' Association (FBA)
- [51.](#) Thomas Murray (Murray)
- [52.](#) USB AG
- [53.](#) VP Securities Services (VP)
- [54.](#) VPS
- [55.](#) Zentraler Kreditausschuss (ZKA)

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