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ESCB-CESR Standards for Securities Clearing and Settlement Systems in the European Union

1. About Nordea

Nordea is the largest financial services group in the Nordic and Baltic Sea region with approximately EUR 270 billion in total assets and operates through three business areas: Retail Banking, Corporate and Institutional Banking and Asset Management & Life. The Nordea share is listed in Stockholm, Helsinki and Copenhagen.

Nordea has significant positions in Nordic banking markets: 40 % in Finland, 25 % in Denmark, 20 % in Sweden and 15 % in Norway and is a leading asset manager in the Nordic financial market with EUR 102 billion (including private banking) under management. The Bank has also significant positions in Nordic insurance markets.

The bank has the largest customer base of any financial services group in the region, including 9.7 million personal customers, 1 million corporate customers and 500 large corporate customers.

Nordea is a world-leading Internet banking and e-commerce operation with 3.5 million customers. Customers are served also through 1 240 bank branch offices in the region and telephone banking services.

Nordea is the leading provider of custody services in the Nordic region. Bank's custody services are aimed at foreign professional investors dealing with Nordic or Baltic securities. Bank's services consist of safekeeping and clearing of securities, income collection and tax services, corporate action and proxy services, clearing services for remote brokers, securities lending and reporting and information services.

Nordea therefore welcomes the opportunity to submit comments on ESCB's and CESR's joint report "*Standards for Securities Clearing and Settlement Systems in the European Union*".

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2. General

November 2001 *BIS Committee of Payment and settlement Systems of Bank for International Settlements (CPSS)* and *International Organisation of Securities Commissions (IOSCO)* issued 19 recommendations for securities and settlement systems. These standards were adapted as a base for a joint work done by *The European System of Central Banks (ESCB)* and *The Committee of European Securities Regulators (CESR)* in order to create standards for the European Union area.

Nordea welcomes the initiative of the standards, which aim to increase safety, soundness and efficiency of securities settlement internationally and are necessary step for integration of the European securities settlement & clearing infrastructure.

3. Definitions of “dominant market position” and “systemically important systems”

Paragraph: The Scope of Application of the ESCB-CESR Standards, 7-10

The group has adopted a risk-based functional approach. Most of the standards are addressed not only to CSD's, CCP's but also to “*custodians operating systemically important systems*” or to “*custodians with a dominant position in a particular market*”. Since the differences between these two terms are not defined it can be concluded that both of the terms used in the text have the same meaning.

The group itself has identified that the definition of “systemically important systems” needs to be further elaborated. In the attached document “The Scope of Application of the ESCB-CESR Standards” it is stated that both value and volume of the transactions, number of systems to which the custodian is linked, nature and number of the custodian's clients and the possibility of being replaced in the event of failure should be considered when trying to identify a “systemically important system”.

The US regulator (SEC) has defined that firms that consistently clear or settle at least 5 % of the value of transactions in the critical market play “significant role in financial markets”. The group proposes that the US example should be followed defining systemically important providers as institutions having a market share of at least 5 % at EU level or 25 % at domestic level. It is although unclear how the market share should be counted; based on volume or value of transactions (or both of them)?

What also should be remembered when developing clearing and settlement standards in Europe is that the US market is not serving a very good example for Europe. Compared with the single US market, EU markets are divided into various smaller local markets and therefore the basis for the same kind of standards than in US is missing.

Considering the different roles CSDs and custodian banks have in the securities markets, Nordea urges the group to reconsider not to impose the suggested standards on custodian banks. If the standards will be imposed on custodian banks, then they should be applied equally to all participants offering similar services despite their market share. Otherwise the competition between custodians will be unfair.

4. Securities lending

Paragraphs 65 – 75

The group emphasises the benefit of establishing centralised securities lending facilities to reduce settlement failures. Centralised facilities lead easily to monopolies, which are not of the benefit for the fair competition on the market. Fair competition between several service providers is the best guarantee for lower costs and continuous development of lending products. Nordea's experiences show that securities lending can be best promoted if the client can choose between different products and when there is a competition in pricing.

Nordea encourages therefore the parties to reconsider the need for centralised securities lending facilities.

5. Credit banking activities

Paragraphs 104 - 112

Operators of systemically important systems that extend explicit credit to participants should employ robust risk mitigation and, whenever practicable, full collateralisation should be applied (Standard 9 – Risk controls in systemically important systems). According to the explanatory memorandum full collateralisation should be the principle and un-collateralised credit should be limited to certain circumstances, e.g. to support the orderly functioning of the market. Amount of un-collateralised credit should be marginal and offered only to institutions with a very high credit standing and according to rigorous risk control measures. The board of directors should approve the limits on total credit exposure to participants, and on large individual exposures.

Traditionally banks main business has been to collect assets from public and to lend them out. The standard does not pay attention to banks having also custody activities. Custody services may be only a minor part of a bank's overall business and is therefore in practice difficult to separate from the bank's other activities. A separation would also complicate the overall rating of a client and therefore the purpose of this standard would not be reached. Separation would not either have any remarkable impact on banks' risk standing capacity.

Nordea wants to emphasise that there is not any need to address this standard to banks, because banks' credit activities are already regulated and supervised by corresponding or stricter obligations given by BIS, local financial supervisors and other authorities.

6. Limitations for outsourcing

Paragraphs 121 - 135

The group suggests a mechanism of pre-approval of outsourcing of clearing and settlement operations to eliminate operational risks.

This proposal will cause some changes for sub-custody business. Before being able to select service providers there should be an approval from local authority, which would add on bureaucracy and delay enforcement of new business structures.

Since service providers of clearing & settlement operations have already been authorised by local authorities and are supervised by them, Nordea does not see any need for a prior approval of outsourcing of clearing and settlement operations.

If the standard anyhow will be implemented, the authorities should at least co-operate to create a public list of already approved service providers. Acceptance of these could be verified during the RFP-process and then each individual case would not need to be approved separately.

7. Access

Paragraphs 151 - 161

The group suggests that CSDs, CCPs and custodians with a dominant position in a particular market should have objective and publicly disclosed criteria for participation to permit fair and open access. Rules and requirements that restrict access should aim exclusively at controlling

risk. This suggested standard is in conjunction with above mentioned transparency –standard, which requires that operators should give public information on services provided and fees in addition to access criteria required by this standard.

We understand that the purpose of the standard is to promote competition and efficiency. According to the standard access should be granted to all participants that have sufficient technical, business and risk management expertise, the necessary legal powers and adequate financial resources so that their activities do not generate unacceptable risks for the operator, or for other users and their customers. Conditions for limiting access should be based on risks only. Denial of access should be explained in writing, and the fairness of the rules, which led to the refusal, should be made subject to third-party review, in conformity with EU competition rules. Criteria that limit access on grounds other than risks to the system should not be permitted.

The proposed model does however not fit to banks with custodian activities. Custody services are only a part of bank's services package provided to the client and form only a part of the client's total liabilities. Banks consider client's risks, liabilities as well as profitability as a whole, without excluding custody services out of the scheme.

Generally every potential custody-client is studied individually based on various criteria, like risk, volumes, other products etc. Custody services are also tailor-made for each client based on clients business model and client needs. Operational risks, need for manual work and system development are also considered. The same applies to fees as a result of negotiations with the client. The client usually selects several service providers for final negotiations based on their Request for Proposal –process (RFP).

If the proposed standard enters into force as such, it would mean that custodians with significant market positions would be required to draw up and publish their criteria for accepting new clients. This would mean that services should be standardised and that fees should be more fixed for similar types of clients, and be published. Since this would without doubt give an advantage for smaller competitors not restricted by the standard, allowing them more freedom and reactivity in choosing clients and in pricing.

Nordea proposes that the standard would not at all be imposed on custodian banks.

8. Transparency

Paragraphs 183 - 187

According to the proposed standard 17 related to transparency CSDs, CCPs and custodians with dominant market position should provide market participants with sufficient information

to identify and evaluate accurately the risks and prices/fees associated with clearing and settlement services. The information should include the main statistics and the balance sheet and be publicly accessible, ex. via the Internet.

It is on a general level acceptable to state that providing information on prices/fees, service offered, statistics etc. would promote competition between service providers, lower costs and improve the level of services. However, in markets, where there is competition between service providers of different size this standard will lead to unfair consequences. If only one or a few service providers are obligated to publish their service descriptions, fees etc, the others who don't have such obligations may use that information to benefit their own business.

Nordea suggests therefore that in markets, where clients can choose between several custodians, this standard should not be applicable to ordinary custodians. The standard should be addressed only to CSDs, CCPs and to such custodians who can be seen as an essential part of the infrastructure (i.e. monopolies).

9. Further information

Should you have any further questions related to this document or about Nordea, please do not hesitate to contact Mr Hannu Halttunen, tel. +358 9 165 53247, fax +358 9 163 53247, e-mail hannu.halttunen@nordea.com or Mr Janne Palvalin, tel. +358 9 165 51012, fax +358 9 163 51012, e-mail janne.palvalin@nordea.com.

Yours faithfully

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