Comments of the

Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks and the Deutscher Sparkassen und Giroverband (DSGV), for the savings banks financial group

on the "Draft recommendations for securities clearing and settlement systems and draft recommendations for central counterparties in the European Union"

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The Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), the Bundesverband deutscher Banken (BdB) and the Deutscher Sparkassen und Giroverband (DSGV) welcome the opportunity to comment on the European System of Central Banks (ESCB) and the Committee of European Securities Regulators (CESR) document entitled "Draft recommendations for securities clearing and settlement systems and draft recommendations for central counterparties in the European Union." In 2005 the Zentraler Kreditausschuss (ZKA) supported the decision of ESCB/CESR to suspend work in this area owing to open issues regarding the scope, content and legal basis of the ESCB/CESR standards.

In view of the cross-border nature of securities clearing and settlement, we very much appreciate the fact that the compliance with the ESCB/CESR recommendations will allow automatic compliance with the recommendations for securities settlement systems of November 2001 and the recommendations for CCPs of November 2004 issued by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions (CPSS/IOSCO).

The BVR, BdB and DSGV similarly supported the 3 June 2008 conclusions of the ECOFIN Council, which invited ESCB and CESR to adapt and finalise the former draft entitled "Standards for securities clearing and settlement in the European Union", but only under the list of conditions enumerated by the Council itself. One of these conditions was that, while (I)CSDs and CCPs fall under the scope of these recommendations, custodian banks do not. We very much appreciate the reasoning behind this, as there already exists a harmonised regulatory background in the form of the Capital Requirements Directive and MiFID for banks, while one is lacking for CSDs and CCPs. Our comments are therefore drafted on the assumption that custodian banks are outside of the scope of the recommendations.

Furthermore, we have long considered the CPSS/IOSCO recommendations to be more appropriately translated into European supervisory practice as recommendations rather than standards – another of ECOFIN's principles – due to the standards' inherent legal character and the range of issues that the recommendations seek to address.

During the public hearing on this subject on 9 December 2008 a representative of the ECB mentioned that no reference to TARGET2-Securities (T2S) was made, as T2S was still an initiative in its project phase. While we acknowledge this fact, we still feel strongly that mentioning T2S as an example would help to reach the goal of the recommendations, because T2S as a DVP platform for settlement in central bank money is a good example of how to minimise risks.

In a more general context, it could be helpful to market participants in order to minimise their individual risk if the assessments of market infrastructures provided for under the recommendations were made adequately transparent to the public.
We take note that, whilst the recommendations no longer address the supervision of custodian banks, further work is being undertaken by the Committee of European Banking Supervisors (CEBS). To this end, the three associations and their members will continue to work with CEBS on these issues to ensure consistent, appropriate and proportionate outcomes, given that custodian banks are fully covered by prudential and market regulatory regimes.

Finally, we wish to make clear that compliance with these minimal obligations by a European infrastructure cannot in any way be leveraged by it as a form of "European passport". If compliance with these recommendations allows the provision of cross-border infrastructure services throughout Europe despite more stringent local regulations, then this set of recommendations would reduce the level of safety and soundness and cause regulatory arbitrage.

In the following section we set out our specific comments on individual recommendations:

Part 1: Draft Recommendations for Securities Settlement Systems

Recommendation 1 (pp. 17-21): Legal Framework

- It seems to us that the concept of “chosen law”, which is the norm in US conflict-of-law rules, should be replaced by applicable law in the European context.

- The imprecise meaning of “interoperable systems” should be clearly defined here as well as in the glossary as CSDs being linked for reasons of interoperability.

Recommendation 2 (pp. 22-24): Trade Confirmation and Settlement Matching

- FOP matching is an international best practice, so that matching should also be recommended for FOP transactions. Furthermore, FOP matching is part of Giovannini barrier 4 and will be implemented in Germany in 2009.

- Timely matching may be complicated in the absence of hold & release mechanisms; hence, all CSDs should offer such mechanisms.

Recommendation 3 (pp. 25-27): Settlement Cycles and Operating Times

- While we agree with the goal of harmonisation of settlement cycles, we would prefer harmonisation at market level, not at the level of individual securities (see the ongoing

discussions on Giovannini barrier 6). For OTC transactions, markets should be allowed to freely negotiate their settlement cycles.

CSD fail management procedures should be harmonised where feasible. For instance, a buy-in regime is considered preferable over penalties, as the associated costs can be clearly allocated to specific transactions.

Recommendation 4 (pp. 28-30): Central Counterparties

- When balancing the costs and benefits of establishing a CCP, the possibility of an already existing CCP servicing the market should also be considered.

- In line with the Code of Conduct, all such new endeavours need to provide for access and interoperability (competitive clearing) from the start.

- Competition on risk models, e.g. on collateral requirements, should be avoided when safety would be reduced.

Recommendation 5 (pp. 31-34): Securities Lending

- While we agree that avoiding or reducing settlement fails is a worthwhile aim, we do not agree that principal securities lending at the level of the domestic CSD is the only desirable or an efficient solution.

- Where a CSD runs a central facility on an agency basis, access should be non-discriminatory. In order to address possible competition concerns in the area of securities lending, we would advocate that participants are offered a genuine possibility of also using other securities lending facilities.

- While Recommendation 6 (C4) states that “CSDs should avoid credit and liquidity risks to the greatest extent possible”, engaging in principal securities lending could be a risk-taking activity.

Recommendation 8 (pp. 41-43): Settlement Finality

- We would like to see a hold & release functionality also for matched instructions, in case there is no unilateral cancellation. However, for on-exchange/CCP transactions, the respective rules of the market operator and/or CCP should prevail.

- We welcome the approach in C7 with respect to links to other settlement systems. It should also be a guiding principle for the design of CSD links under T2S.

Recommendation 10 (pp. 47-49): Cash Settlement Assets

- We believe (in line with the 2 December 2008 ECOFIN conclusions) that central bank money offers the highest degree of security against failure of a settlement agent and should therefore be the settlement asset of choice.

- If a CSD has some kind of remote access to a central bank (C3), its users should be granted the same possibility.

Recommendation 11 (pp. 50-55): Operational Risk

- In paragraph C16 (p. 54) the recommendation requires CSDs to inform their participants of functions that have been outsourced. Furthermore, in case of a material operational failure, a CSD should explain to its participants why it occurred and how it is to be prevented in the future. There also need to be clearly defined rules for the allocation of costs in case of operational losses.

- The recommendations regarding the outsourcing of services should also apply to services which a CSD sources in from a joint venture.

Recommendation 14 (pp. 63-65): Access

- In paragraph C4 (p. 64/65) it is mentioned that CSDs may apply different access criteria to various categories of participants (e.g. custodians). It needs to be made sure that the same access criteria apply to all entities in the business on an equal footing.

- Not only the access rules, but also the actual process for reviewing memberships or account opening, need to be non-discriminatory and transparent.

Recommendation 15 (p. 66): Efficiency

- These rules should also apply to subsidiaries of CSDs located outside the EU if they are part of a group located in or having material business in the EU.

Recommendation 16 (pp. 67-69): Communication Procedures, Measuring Standards and Straight-Through Processing (STP)

- The employment of translation or conversion mechanisms as proposed in paragraph C9 (p. 69) is only acceptable if it is made sure that users can access them without discrimination or additional costs. It is particularly important that CSDs are SWIFT compliant, but allow the use of alternative communication mechanisms such as file transfer.

Recommendation 19 (pp. 75-78): Risks in Cross-System Links or Interoperable Systems

- We do not follow the thrust of this recommendation and suggest that it could be redrafted in a clearer and more accessible manner.

Part 2: Draft Recommendations for Central Counterparties

Recommendation 1 (pp. 80-84): Legal Risk

- It should be clearly stated to whom the recommendations apply. For this purpose the recommendations lack a clear definition of what a CCP really is as opposed to other institutions. The designation under the Settlement Finality Directive could be a criterion for defining the scope of the recommendations.

- To ensure consistency with the European legal background against which the recommendations are set, we suggest that the term "applicable law" would be more appropriate than "chosen law," the latter being a term seemingly inherited from the original CPSS/IOSCO drafting.

Recommendation 2 (pp. 85-87): Participation Requirements

- The rules and especially their application/interpretation by the CCP must be available in written form. Where the CCP engages in risk rating of its participants, the criteria should be broadly available to the potential participant explaining the reason and consequences of a certain risk rating.

- The participation requirements should not rule out the CCP being responsible for gross misconduct and its rules and regulations should be in line with internal best practices such as the SWIFT handbook (for instance in relation to margin calls).

- CCPs should treat participants' data confidentially and comply with European data protection rules. They should also provide information on the location of their operations and in which jurisdiction client data is held.

Recommendation 3 (pp. 88-89): Measurement and Management of credit exposures

- If a CCP clears multiple trading venues, members who are using the CCP only for one market should not be exposed to losses of trading members of the other venue (e.g. segregated margin calls, default funds). Interest earned on margins should be shared with users. CCPs should offer the possibility of cross margining if members opt in on a non-discriminatory basis.

Recommendation 4 (pp. 90-92): Margin Requirements

- We seek clarity on the definition of "highly liquid instruments" for the purposes of Recommendation 4.

- Competition on risk models used to calculate margin requirements needs to be ruled out if this would compromise safety standards.

Recommendation 5 (pp. 93-97) Other Risk Controls

- It needs to be made sure that the regulatory requirements for CCPs and their participants are well aligned. The rules governing the CCP should allow the clearing members to comply with provisions that regulate their relationship with their customers. A collateral pledge should therefore only comprise proprietary assets of the general clearing member, but no assets that belong to its customers (non-clearing member). Only if a clear differentiation is possible between the assets of those non-clearing members that have given their consent and those that have not done so may the pledged collateral also comprise certain customer assets. The rules of the CCP should clearly recognise this.

- Whilst it is relevant to seek risk mitigation around the default of the largest participant, scenarios where the simultaneous crystallisation of different risks could occur should also be taken into account.

Recommendation 6 (pp. 98-101): Default Procedures

- The triggers of a default event should be clearly defined in paragraph C3 and must not be arbitrary. They need to be reasonable and should not include occurrences that are common in a business relationship like a dispute over commercial terms or a complaint made about a billing mistake. Security aspects and the basic interests of the clearing members need to be balanced.

Recommendation 7 (pp. 102-104): Custody and Investment Risks

- It should be mentioned in paragraph C2 that an institution providing custody services to the CCP should have Chinese walls in place in order to shield these functions and the information gained through these from its brokerage (user of CCP) activities.

Recommendation 8 (pp. 105-109): Operational Risk

- We see a contradiction between paragraph B3 under Recommendation 6 of the CSD recommendations (p. 35) requiring the separation of CCP services into a distinct legal entity and the statement made in paragraph C8 mentioning the possibility for a CCP to embark on activities not related to its CCP function.

Recommendation 10 (115-118): Physical Delivery

- The recommendation fails to take into account the case where delivery cannot be carried out due to lack of securities. The consequence would usually be a buy-in with cash compensation. This possibility should be incorporated.

Recommendation 11 (119-123): Risks in Links between CCPs

- Relevant to Recommendations 9-11: In addition to harmonising operating hours based on Target days and operating times, daily schedules should be harmonised (or at least coordinated) to avoid risks related to situations where assets are transferred from one CCP to another. These situations could include both linked CCPs and cases where securities are bought in one trading venue and sold in another and where those trading venues use different CCPs.

Recommendation 13 (126-128): Governance

- Cross-border CCP groups should allow local markets they serve sufficient voice in the strategy of the firm. If a company is mainly governed from a foreign market, this is important to control its activities in the local market and to make sure it caters to market needs.

Recommendation 14 (129-130): Transparency

- We agree that transparency is of great importance for participants to identify and evaluate the costs and risks associated with the use of a CCP. However, we believe that transparency should be applied more broadly than is recommended in the text. Recent turmoil has shown how important it is to have internationally consistent and transparent rules and procedures in place in case of distress. Participants should know what to expect in such a case and should not have to deal with inconsistent approaches if they are using more than one CCP.