

Response**CESR/ESCB Consultation paper****Draft Recommendations for Securities Settlement Systems and
Draft Recommendations for Central Counterparties****(CESR/08-749)**

The European Banking Federation (EBF)¹ welcomes 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.”

Executive Summary

The ESCB-CESR Recommendations are timely and appropriate, especially in the context of ECOFIN’s December 2008 conclusions on clearing and settlement which underscore the importance of the safety and soundness of central infrastructures.

For central clearing activities, it is of the utmost importance that the Recommendations provide the appropriate incentives to Central Clearing Counterparties (CCPs) and offer the optimal level of protection for their users and the market as a whole.

For central settlement activities, the EBF notes the Council’s emphasis on the use of central bank money and eliminating credit risk as far as possible within Central Securities Deposits (CSDs), as a possible way to strengthen the safety and soundness of central infrastructures, is an area only partially covered by the Recommendations.

The Recommendations provide a degree of global consistency, which is of course welcome, but due to their non-binding nature their uptake and application relies on a strong moral force. Users will therefore pay careful attention as to how supervisors apply the Recommendations going forward.

Likewise, the EBF advocates caution, in respect of the Recommendations being used as the *de facto* basis for a European passport in the post trading space. Much will depend on how the Recommendations will be taken up by supervisors in practice and how far this process achieves genuine comparability for the purposes of achieving a mutual understanding of the forms, functions, and legal bases underpinning central infrastructures.

¹ Set up in 1960, the European Banking Federation is the voice of the European banking sector, with over €30,000 billion assets and 2.4 million employees in 31 EU and EFTA Member States. The EBF represents the interests of some 5,000 European banks: large and small, wholesale and retail, local and cross-border financial institutions. Since the vast majority of securities business in Europe is carried out by banks, the EBF is an authoritative voice on the evolution of financial markets in general and securities business in particular.

General remarks

1. In view of the cross-border nature of securities clearing and settlement, **the EBF welcomes the fact that compliance with the ESCB-CESR Recommendations will ensure 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).
2. **The EBF supported the decision of the ESCB-CESR to suspend work in this area in 2005** owing to open issues regarding scope, content, and the legal basis of the ESCB-CESR recommendations then labeled ‘Standards.’ The Federation has long considered the CPSS/IOSCO recommendations to be more appropriately translated into European supervisory practice as **recommendations rather than standards** on account of their inherent legal character and the range of issues they seek to address.
3. **The EBF similarly supported the 3 June 2008 conclusions of the ECOFIN Council** which invited the ESCB and the CESR to adapt and finalise the former draft entitled “Standards for securities clearing and settlement in the European Union,” but only under the conditions that it respects the principles listed by the Council itself.²
4. This decision we felt was timely given that the post trading landscape was adapting itself rapidly, following recent legislative, public policy, and self regulatory initiatives in the area, underlining a renewed focus on the safety and soundness of the infrastructures which have a critical central function in securities clearing and settlement. It is regrettable however that the Recommendations (or at the very minimum the introductory text to the Recommendations) do not make **reference to [the development of] central settlement facilities in Europe**, for example, and primarily, the TARGET2-Securities platform, and the role that such facilities are expected to play in respect of providing secure and reliable cross-border settlement of securities in the future.
5. In respect of clearing, the Federation advises that **the notion of a Central Clearing Counterparty (CCP) must be used with a degree of accuracy**. A CCP interposes itself between counterparties in a financial transaction – becoming the buyer to every seller and the seller to every buyer – thereby performing an important central function. The Recommendations should therefore only apply to a CCP in this sense

² Namely: (i) the adopted text should take the form of non-binding recommendations solely addressed to public authorities and not to market participants; (ii) its scope should include international central securities depositories and exclude custodian banks; and (iii) on credit and liquidity risk controls, the benchmark accepted by the G10 – namely CPSS-IOSCO Recommendation 9 for securities settlement systems of 2001 — should be adopted.

and not capture clearing arrangements in general. Moreover, the Recommendations should only be viewed as baseline regulatory requirements, especially for CCPs which require additional regulatory attention to ensure appropriate risk mitigation.

6. **The EBF takes 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 EBF will continue to work with CEBS on these issues to ensure consistent, appropriate, and proportionate outcomes, given custodian banks are caught by prudential and market regulatory regimes.
7. Due to the market reorganisation since the CPSS-IOSCO Recommendations were first published, and today's greater degree of European integration in the post trading space, **more emphasis could be placed on the monitoring of cross-border operations and risks**, i.e. risks emanating from the home market and crystallising in other market(s).
8. The above point coupled with the Recommendations being quite high level in nature – and appropriately so – underscores **the need for CESR members to work effectively and efficiently together in the monitoring of the implementation of the Recommendations.** To this extent we urge CESR to specify how it would intend to manage relations and tasks between supervisors in this important and technically complex area.

Specific remarks on the proposed recommendations

9. This section sets out the comments and reflections of the community of users of clearing and settlement infrastructures. In the absence of specific comments, the EBF does not take a position.

Part 1: Draft Recommendations for Securities Settlement Systems

Recommendation 1: Legal Framework

10. To ensure consistency with the European legal background against which the Recommendations are set, the EBF suggests 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: Trade Confirmation and Settlement Matching

11. The EBF firstly notes that the Recommendations only refer to **‘Delivery versus Payment’** (DvP) settlement.

12. Secondly, whilst banks agree with the direction of the Recommendation it must be stated that it could also be read as being **relevant for entities other than Securities Settlement Systems**.
13. Thirdly, and similar to the point we raised in paragraph 10 (above), the terms “affirmation” and “confirmation” are more often associated with securities settlement in the US market; **“matching” would be a more appropriate term for the European context**.

Recommendation 5: Securities Lending

14. To address possible competition concerns in the area of securities lending, **the EBF strongly advocates that participants are always offered the genuine possibility of using other securities lending facilities, from different providers, alongside those offered by the CSD**.
15. Furthermore, it is important to take into account the ongoing discussions surrounding the development of single settlement facilities in Europe. Taking these into account, the Federation advocates that **CSDs could have in place a mechanism to lend securities but only do so strictly as a last resort (i.e. in the event of failed trades)**. From a safety and soundness perspective, given the critical role of central infrastructures to ensuring financial stability, the CSDs, operating ultimately as securities lending agents, ought not to take on the risk arising from securities lending themselves if this could be at all avoided.

Recommendation 7: Delivery versus Payment (DvP)

16. It is important to note once again that **the Recommendations focus solely on DvP settlement**.

Recommendation 9: CSD Risk Control to address Participants’ Failure to Settle

17. Consistent with the point raised above with respect to securities lending (paragraph 14) there are **important safe and soundness considerations to be taken into account in the area of International Central Securities Deposits [(I)CSDs] taking on credit risk**. Today, more than ever, central infrastructures must be considered to be as stable and secure as possible to restore a degree of market confidence in general. Through (I)CSDs limiting, or preferably eliminating, credit risk from their operations, we feel that the system could be more readily be considered as “safe” and “sound.”

Recommendation 10: Cash Settlement Assets

18. Consistent with the points raised in respect of (I)CSDs exposure to credit risk (paragraphs 14-15 and 17 above) and in line with the 2 December 2008 ECOFIN

conclusions, we conclude that **settlement in central bank money offers a high degree of security and is, therefore, highly preferable.**

Recommendation 12: Protection of Customers' Securities

19. The EBF understands the Recommendations to be targeted towards Issuer CSDs, but notes that the Investor CSD concept is introduced under this Recommendation. To achieve consistency throughout the document and with the regulatory focus of the package of Recommendations as a whole, **the EBF would suggest that the Investor CSD reference could be deleted.**

Recommendation 14: Access

20. Noting that the Recommendations call for “**more stringent criteria for custodians**”, the EBF firstly asks **ESCB-CESR to explain clearly the basis for this statement**, and secondly, advocates that **the same access criteria apply to all entities in the business on an equal footing.**

Recommendation 17: Transparency

21. It is appropriate to highlight that following the implementation of the Pan-European Code of Conduct for Clearing and Settlement ('the Code') by its signatories, there is generally speaking an increased level of transparency around published prices, variable transparency around rebates and discounts, but in part, owing to the inherent diversity of the post trading space in Europe, there is widespread difficulty when it comes to making a like-for-like comparison of the service offerings of the respective infrastructures. The EBF, representing a broad community of users of securities infrastructures, continues to work with the signatories of the Code to improve the situation with respect to price transparency and comparability. **ESCB-CESR ought to recognise therefore the wider policy and market context of this Recommendation and the current initiatives underway in order to work through similar issues to those highlighted by this Recommendation.**

Recommendation 18: Regulation, Supervision and Oversight

22. The EBF notes that the Recommendations will have a certain moral force to coax regulators in a particular direction but that typically **national regulators would generally apply more stringent requirements** than what are set out in the consensus achieved on the Recommendations. The Recommendations should be seen therefore as the baseline expectations of a central infrastructure to provide a safe and secure clearing and settlement environment.

Recommendation 19: Risks in Cross-System Links or Interoperable Systems

23. The EBF does not follow the direction of this Recommendation and suggests that it could be **redrafted in a clearer and more accessible manner**.

Part 2: Draft Recommendations for Central Counterparties

Recommendation 1: Legal Risk

24. Consistent with comments in paragraph 10 (above), the notion of “chosen law” is inappropriate in the European context, especially regarding the proprietary aspects of holding of securities and law governing collateral. **The words “chosen law” should be systematically replaced with “applicable law” or “relevant law.”**

Recommendation 4: Margin Requirements

25. Clarity is sought on the **definition of “highly liquid instruments”** for the purposes of Recommendation 4.

Recommendation 5: Other Risk Controls

26. 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 8: Operational Risk

27. The Recommendations could be more explicit as to how **risk contagion** across markets could be mitigated when CCPs operate on multiple markets.

Recommendation 11: Risks in Links between CCPs

28. 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: Governance

29. The EBF advocates the need for **appropriate user consultation** by market infrastructures before relevant and significant changes are made, for example with respect to rules and schedules.