



London, 15 January 2009

European Central Bank
Secretariat Division
Kaiserstrasse 29,
D- 60311 Frankfurt am Main
Germany

CESR
Victoria Powell,
Director for Communication,
11-13 avenue de Friedland,
75008 Paris
France

BY ELECTRONIC MAIL

Dear Sirs,

Re: ICAP Response to CESR/ESCB Consultation paper

ICAP is grateful for the opportunity to respond to this CESR/ESCB consultation paper. As the world's leading interdealer broker the company sits at the crossroads of wholesale financial markets, facilitating the flow of liquidity in OTC transactions between commercial and investment banks and other major financial institutions around the world. On behalf of its customers the firm transacts on average US\$2.3 trillion of volume each day. Its operations are connected to over 2,000 dealing rooms in 76 countries worldwide.

ICAP owns and operates, outright or through equity stakes, a number of OTC trading platforms and post trade services businesses and has a strong interest in the continuing health, efficiency and safe operation of the global wholesale financial markets.

The recommendations in the consultation paper for Security Settlement Systems and Central Counterparties will play a crucial role in the future role of OTC markets in today's economy. As ICAP businesses form part of the clearing and settlement area through the power of authority given by the clients to instruct settlements on their behalf, the regulatory overhaul may create unintended consequences in some areas. It is in this spirit that we offer our advice on certain points in the consultation document.

Today's existing OTC infrastructure depends to a large degree on simplified processes that bring greater transparency and increase robustness where needed. In many products the wider adoption of CCP give-up and/or central clearing will become matter of fact. Strengthening the regulatory regimes, prudential oversight, and risk management while ensuring that regulation is efficient, will not stifle innovation but encourage expanded trade in financial products and services.

We remain at the disposal of CESR and the ECB to provide additional material where this is required and look forward to discussing these matters further in the near future.

Yours sincerely

A handwritten signature in black ink, appearing to read "De Vidts", with a long horizontal line extending to the right.

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ESCB/ CESR draft recommendations for securities settlement systems and for central counterparties

ICAP consultation paper response

January 2009

ICAP welcomes the ESCB/CESR draft recommendations for securities settlement systems and for central counterparties. The proposed recommendations have the potential to significantly contribute to the goal of a more robust post trade infrastructure, particularly through the further development of the following points:

1. Wider adoption of Electronic Trading
2. Quicker settlement cycles in all securities markets
3. Faster and automated affirmation/confirmation of all derivatives trades
4. Greater use of pre-booking netting
5. Wider adoption of portfolio reconciliation
6. Wider adoption of portfolio compression in derivatives markets

Furthermore, we would like to express our opinion on the following chapters in your consultation document.

Part 1: Draft recommendation for securities settlement systems

Recommendation 2: Trade confirmation and settlement matching.

B.3. The use of electronic trading systems is well established in the some markets (bonds, repo) and should further be encouraged. That would additionally improve settlement towards T+0 and reduce counterparty risk for non-central counterparty cleared trades. Open access to all clearing and settlement venues will avoid inefficiency and market fragmentation, enhancing interoperability.

Recommendation 3: Settlement cycles and operating times

C.11. ICAP has specific rules in place to encourage orderly trading and settlement. All trading activity is actively followed and interventions by qualified staff are made when deemed necessary. Fails in settlement will see improvements with the enhanced use of electronic trading and decrease possible failures of settlement. Wider adoption of electronic trading would make the recommendation for a maximum size for settlement instructions void. At the same time central counterparties already have a practice of maximum size of settlement instructions after netting, a practice called “shaping”.

Recommendation 4: Central counterparties (CCPs)

C.6. There is potential confusion in this chapter between a true CCP and the arrangements described and between part 1 and 2 of this consultation. An exchange or CSD cannot be compared with a CCP. To indemnify market participants against losses from counterparty defaults may create the false illusion of protection by the users. ICAP suggests further clarification of the bilateral nature of the arrangements in place and clearly mention that, although similar to the function of a CCP, this is absolutely not the same.

Recommendation 6: Central securities depositories (CSDs)

As mentioned in this Recommendation, the CSD activities necessitate separating the CCP services into a distinct legal entity. In this respect not only settlement but also trading activities should clearly be separated. For all products (be they equities, fixed income or derivatives) a CSD should not be the owner of a trading platform, likewise for a CCP. Each layer of activities should be separated legally but also functionally. This would provide unrestricted access of counterparties without blurring the lines of the various activities. In those markets that do not already operate a central counterparty, introducing a CCP/clearing house would have many benefits,

including risk mutualization and acting as a “shock absorber” in the event of the default of one or more market participants.

Recommendation 7: Delivery versus payment (DVP)

B. 2. ICAP does not take principal risk. As such only securities transactions against cash between CSDs can be settled on behalf of our clients on a DVP basis.

Recommendation 8: Timing and settlement finality

C.1. The timing of settlement finality is crucial for orderly settlement of all transactions, specifically in the same currency. To enhance the use of electronic trading systems, national legislation should be equal throughout the currency union (Euro specifically in this case) as identified in the Giovannini report barrier 2. Unequal timing creates systemic risk and should immediately be raised to a unique European settlement platform (real time). In the same spirit all CSDs in the Euro currency zone should be operating on Target days and identical cut-off times.

C. 8. In reference to this article “a significant number of batches during the day” should be tightened in two areas: (a.) covering the same timing throughout the settlement cycles in one single currency; and (b.) batches within a certain timeframe. This would greatly reduce inefficiencies and come close to a real time settlement system.

Recommendation 10: Cash settlement assets

C.6. The provision of settlement facilities in both central bank money and commercial bank money should be granted equal to all participants. Clarification of “all participants” would be useful including trading platforms that instruct on behalf of clients. The benefit of the ESCB/CESR recommendations can only be maximized when all trading venues have access to CSD facilities. This would further improve developments towards electronic trading, the use of STP in a T+0 environment for all instruments and allow better and more extensive use of the existing OTC market infrastructures.

Recommendation 14: Access

Consistent with Mifid this recommendation should equally be applicable to MTFs as clients would benefit from electronic trading platform facilities in an organized way. Many OTC market infrastructures have been tested in the current financial market turmoil showing operational efficiencies. To further develop current market infrastructures would continue to reduce operational, contingent credit and market risks. Unrestricted access to both CSDs and CCPs would additionally increase auditability and processing capacity of existing OTC market infrastructures, materially reduce costs and improve the operating performance and return on capital of users.

B.2. Access to all participants should be clearly identified on the website of each provider by each CSD or CCP. Denial of access should indeed be permitted only on the basis of a pre-determined limited set of criteria and explained in writing. The timetable for reviewing a participant’s application for access should be clearly laid out and the final decision should be required within a short period, but no later than 6 months of the original application (to avoid unnecessary delays by the CSDs/CCPs).

Part 2: Draft recommendations for central counterparties

In the Monitoring Group (MOG) established by the European Commission issues have been identified in the CCP area for equity traded products. Similar issues exist in the fixed income area. Here too access to the CCP/clearing house must be open to all execution venues on a level playing field to avoid diminished competition, increased costs and reduce flexibility that accompany single execution venues.

It is therefore crucial that requirements are clearly stated and publicly disclosed avoiding discrimination against MTF’s and this for all potential products.

In those markets that do not already operate a central counterparty, introducing a CCP/clearing house would have many benefits, including risk mutualization and acting as a “shock absorber” in the event of the default of one or more market participants.

Greater use of CCP functions should also potentially facilitate further progress with portfolio reconciliation and compression and netting of transactions.

Recommendation 2: Participants requirements

B.2. Establishment of independent third party review of access refusals is a priority. Given the cross border dimension and the need to overcome entrenched positions of national champions it is a necessity that the review function is undertaken at EU level. Review by an independent EU body will strengthen confidence in the system, guard against bias competition and guarantee equal access to the use of infrastructures. Equal use should have an equal price, avoiding anti-competitive measures from the provider.

Recommendation 11: Risks in links between CCPs

C.7. In light of the unwinding of Lehman in September 2008, particular attention should be paid to unwinding of transactions by each CCP in Europe. ICAP has been involved through the various CCPs in the orderly settlement of outstanding trades. These findings should be studied and compared by the regulators in order to evaluate the potential risk in links between CCPs. The potential biggest risk to market participants is the scaling down of risk assessment by each of the CCPs due to competition between these types of providers - a risk that should be avoided at all costs.