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Committee of European Securities Regulators
By email: Secretariat@europefesco.org

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Dear Mr Kazarian and Mr Moeliker

Consultative Report – Standards for Securities Clearing and Settlement Systems in the European Union.

The Euroclear group (comprising Euroclear Bank, Euroclear France, Euroclear Netherlands and CRESTCo) is pleased to provide its comments to the European System of Central Banks and the Committee of European Securities Regulators (ESCB/CESR) on their proposed standards for securities clearing and settlement systems in Europe as issued on August 1, 2003.

We welcome the open approach taken by ESCB/CESR and its decision to involve all interested parties in the discussion by launching an industry consultation on the standards and their scope of application. This consultation should lead to standards that ensure increased safety, soundness and efficiency of securities clearing and settlement systems in Europe.

We believe that appropriate standards calling for consistent regulation across providers of clearing and settlement services in Europe are a key step towards better risk reduction and stability of financial markets in Europe. It is clear that, currently in Europe, settlement services are offered not only by CSDs and ICSDs, but also by agent banks. For instance, agent banks handle about 90% of the settlement of cross border equities transactions in Europe today. Consequently, the ESCB/CESR functional approach to regulation is fundamental to ensuring the security and efficiency of European financial markets, for the benefit of investors, issuers and financial firms alike.

We believe that this overlap of the roles of agent banks and (I)CSDs for settlement activity is not, as such, a source of undue risk, but rather allows for greater choice and competition for customers. Consequently, it can be a source of efficiency for the market. We believe however, that where an individual agent bank handles a large share of Europe's domestic or cross border settlement and is considered by regulators to be systemically important in Europe, then certain rules that the regulators apply to (I)CSDs to mitigate risks related to settlement activity should also be applied to that systemically important agent bank. Otherwise, the differences in the regulatory environment can create incentives for a shift of settlement activity from CSDs and ICSDs to agent banks, which, even if systemically important, would not be subject to the same rules seeking to prevent systemic risk as (I)CSDs.

We believe however, that some adjustments or clarifications of the proposed standards would be appropriate:

- We are not convinced that such standards should be applied to those agent banks that, while important in their local markets, are not systemically important at a European level, since the risks are arguably more localised and appropriate coordination between national regulators on their application of rules may be sufficient.

- Also, it should be made clear that the ESCB/CESR standards, which have been designed to address risks that arise in the context of settlement, are not meant to apply, directly or indirectly to (or serve as a precedent for) other activities of service providers in the securities industry (e.g., global custodians, investment banks, fund managers, and the like), as they do not themselves handle significant settlement activity (they rely on (I)CSDS and agent banks for such activity).

- Some of the ESCB/CESR standards reflect rules that should already be applicable to all institutions that hold client assets; for instance, the principle that a settlement service provider should not use a client asset without that client's explicit consent (see for instance Standard 5 on Securities Lending and Standard 12 on Protection of Customers Securities).

- The ESCB/CESR standards introduce a new category of "custodians with a dominant position" for which only certain standards apply. We believe that this category could create confusion with existing competition law rules which prohibit the abuse of a dominant position under the Treaty of Rome or in national legislation. As the ESCB/CESR consultation document itself states, "issues related to competition do not fall within its mandate as they would be better dealt with by the relevant national and European authorities". Rules on Governance (Standard 13) and Access (Standard 14) for instance seem ill-suited for agent banks. Agent banks, like any other company, would in any event be subject to competition law rules on matters such as discriminatory pricing or access under the relevant applicable competition law if they occupied a dominant position.

- We welcome that the standards do not require full collateralisation by systemically important settlement service providers such as ICSDs and agent banks. Full collateralisation, if applied to a settlement service provider such as an ICSD but not to a systemically important agent bank, would simply force customers to shift their business from the ICSD to such agent banks. Euroclear Bank has decided to apply very stringent risk procedures, including a very high level of collateralisation of customer credit exposure (about 95%), in addition to (not in lieu of) the range of other mitigating risk measures typically applied by sophisticated banks. Nevertheless, we do not believe that it is practical to apply full collateralisation requirements to *any* bank. This is because such a requirement would fail to take into account that not all customers are able to pledge assets as collateral. For instance, many custodians are unable, under existing regulations, to pledge their clients' assets in support of credit required for settlement purposes without their clients' prior approval. It would be uneconomic for these custodians to set aside their own proprietary assets for such settlement activity. Secondly, all providers of settlement services should have the ability, in periods of unexpectedly high settlement activity, to grant their customers unsecured credit intra-day in order to ensure settlement efficiency. Not to be able to do so would have a negative impact on settlement efficiency which in turn would increase risk for the customer and for its counterparties. Consequently, we are concerned that Standard 9, and in particular section 109 of the explanatory notes that accompany it, continue to create an excessive bias for full collateralisation. While collateral is a very valuable mechanism for reducing

credit risk, regulators should take a broader view on mitigation tools available to banks as recognised in prudential regulation and in the Basel rules. In addition, we believe that the market would welcome a more detailed assessment by ESCB/CESR of how the standards would relate to the existing Basel capital rules and the forthcoming Basel 2 rules.

- We strongly support Standard 11 on Operational Reliability and its focus on the adequacy of business continuity plans, back-up facilities and disaster recovery procedures. It is vital that all systemically important settlement systems can continue to operate effectively in any contingency situation. We believe that systemically important settlement service providers will have to meet greater standards of security than have applied so far, and suggest that the explanatory notes to Standard 11 should not be restrictive in this respect.

- Although the standards are structured around the concept of functional regulation, we note that Standard 6 is focussed specifically on the need to eliminate risk in the operations of CSDs. We believe that the request to avoid taking risks - to the greatest practicable extent - is not achievable for CSDs as they are unavoidably exposed to operational risk; additionally, most CDSs are also exposed to at least some custody and legal risks in the services which they offer their customers however stringent their policies and practices may be - for instance, in the area of corporate actions processing. Regulators should be vigilant that the risks taken are commensurate with the expertise of, and the capital held by, the CSD, but recognise that risks cannot be eliminated completely.

- We strongly support the contents of Standard 18 on regulation, supervision and oversight. We urge ESCB/CESR to take the necessary measures to ensure consistent and simultaneous application of the standards to all relevant entities, as well as transparency of compliance with the standards.

- We would encourage regulators to ensure an early and speedy process of implementation of the standards at national level in all relevant countries. Implementation directly through incorporation in regulators' rules books may prove the quickest way to proceed. It will be important also to ensure sufficient monitoring and transparency through ESCB/CESR of the actual implementaion of the standards. In any event, implementation should take place in a uniform way across all countries and institutions concerned. If the

monitoring showed that direct implementation through regulators' rule books was not proving an efficient way forward, other methods of implementation should be considered.

We have included a number of more detailed comments and suggestions in the attached note.

We would welcome the opportunity to further discuss with ESCB/CESR our views and comments articulated in this document, and we remain at your disposal for any clarification on any of the points covered.

Yours sincerely

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