

# **ESCB/CESR Consultative Report – Standards for Securities Clearing and Settlement Systems in the European Union**

## **Euroclear Response**

**October 2003**

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## 1. The need for functional regulation

We strongly support the concept of risk-based functional regulation adopted by ESCB/CESR. Such regulation should ensure that the risks related to the function of "settlement" are subject to the same regulatory standards relating to the management or mitigation of such risks, regardless of whether settlement occurs in CSDs, ICSDs or agent banks.

Consistent regulation - based on the functions performed by institutions rather than on the institutions themselves - is crucial for the safety and stability of EU financial markets. Functional regulation is the correct answer to the rapid evolution of clearing and settlement in Europe where the introduction of the Euro has increased trading across sectors, away from national boundaries. This has resulted in an increased need to settle cross-border transactions. The role of settlement provider for such cross-border transactions is performed by some CSDs and ICSDs but, more importantly, agent banks. These banks often operate an omnibus account in the CSD/ICSD. In large agent banks where both brokers and custodians hold their accounts, a large number of transactions settle through the agent bank's books. Such internalisation of settlement is particularly important in the area of cross-border equity transactions where the business is concentrated with a limited number of agent banks. Over 90% of such transactions are settled by agent banks.

As a result of this evolution, the risks related to the function of "settlement" are also present in those banks that substantially internalise settlements, not just in the CSD/ICSD. To safeguard financial stability and minimise systemic risks, regulators must identify the risks related to the function of settlement, assess their importance, establish rules ensuring these risks are adequately controlled, and apply such rules consistently across all systemically important providers of settlement services.

"Institutional regulation" would not only deny the above-described evolution, it also may result in an increase in systemic risk rather than a decrease; applying strict rules only to CSDs/ICSDs could result in users moving their business to agent banks, which, even if systemically important, would be subject to less strict rules.

In applying functional regulation, ESCB/CESR should ensure that the standards focus on risk mitigation and should:

- (a) Provide an adequate framework to mitigate the operational and credit risks inherent to the provision of settlement services; and
- (b) Be extended to cover all entities that incur such risks that can be considered "systemically important" in the area of settlement.

**(a) Defining which providers of settlement services are systemically important**

In line with the above, we welcome that ESCB/CESR propose that the application of the standards be extended to all systemically important providers of settlement services rather than being limited to CSDs and ICSDs.

We note however, that the standards use the word 'custodians' to cover the activities of both global custodians and agent banks, although their roles and functions in the process of clearing and settlement are very different. Global custodians provide their customers with a range of asset-servicing services and undertake very little internalised settlement activity. Agent banks on the other hand are very active in providing their customers with both domestic and cross-border settlement services, and some of the largest undertake significant settlement activity on their own books. Consequently, we believe that the standards should be focussed on those agent banks which are judged by the regulators to be systemically important.

The consultation document derives systemic importance from two different circumstances:

First, an institution is systemically important if it operates a core, and often unique activity in the settlement process and ensures key functions for financial stability and the smooth functioning of the financial markets. In other words, it operates a systemically important system. Applying the first principle means that all EU CSDs and ICSDs will be considered systemically important and thus subject to the standards. We agree with this principle.

Secondly, an institution can be systemically important if it settles amounts so large – in terms of volume and value – that its failure could potentially jeopardise the smooth functioning of payment and settlement systems, as well as the stability of financial markets. We also fully support this principle. It implies that certain agent banks that are very active in settlement can equally give rise to systemic risks. We agree with ESCB/CESR that the extent of any systemic consequences will depend on:

1. The size of the activities (value and volume of transactions processed)
2. The number of "systems" the provider is linked to (payment systems, CSDs, custodians, cash correspondents)
3. The nature of its clients (if these are large financial or non financial institutions, the risk of contagion and wider implications is bigger)
4. The possibility of being replaced in case of failure

We believe that ESCB/CESR should specifically focus on agent banks that are systemically important providers of settlement services at a European level, while leaving the regulation of such institutions at national level to national regulation.

**(b) *Custodians with a dominant position***

In the proposed scope of application of standards 13 (Governance), 14 (Access), 15 (Efficiency) and 17 (Transparency), ESCB/CESR introduces the notion of “custodians with a dominant position”.

We feel that the ESCB/CESR standards should focus on their primary objective of reducing risks related to securities clearing and settlement in EU by applying the risk-based functional approach mentioned above. In this context, we question the need for extending the scope of application of these standards to “custodians with a dominant position”.

We firmly believe that ESCB/CESR should avoid using the term “dominant position” as this term has very specific competition law connotations which may lend itself to being differently interpreted in this distinct context. In addition, the use of this term appears to contradict the position recognised in paragraph 5 of the consultation paper that competition law is within the competence of competition law authorities whether at domestic or at European level.

## **2. General Comments on the Standards**

We detail below a number of general comments on some of the main proposed standards. Detailed comments on each standard can be found in Annex 1.

### ***Standard 6 – Central Securities Depositories (CSDs)***

Euroclear welcomes that this standard recognises that there is no single definition of "CSD" and no single list of "CSD" functions. We note however, that Standard 6 is mostly designed for markets whose securities are fully dematerialised. As many European markets still have a portion of physical securities, the respective CSDs cannot safeguard the integrity of the total amount of the securities issue; a similar issue occurs in the eurobond market. We therefore, propose to re-name the standard as "safeguarding the integrity of securities' issues". The standard should include all measures to mitigate risk related to this function, regardless of the entity performing the function (CSD, registrar, issuer). By doing so, this standard would be aligned with the overall adopted functional regulation.

Euroclear notes that Standard 6 states "CSDs should avoid taking risks to the greatest practicable extent" However, the function of "safeguarding the integrity of securities issues" unavoidably includes operational and indeed some financial risks; these risks can materialise through the day-to-day operation of the settlement system.

We therefore, propose that the text should read "entities responsible for safeguarding the integrity of securities issues should mitigate the risk they incur to the greatest practicable extent". Standard 6 should then refer to Standard 11 which describes how to mitigate operational risk, and to Standard 9 for management of any credit risk.

### ***Standards 9 – Risk controls in systemically important systems***

Standard 9 should define the credit risk it is targeting to mitigate, i.e. credit exposure resulting from short-term (even intra-day) credit granted to customers to facilitate settlement of their securities transactions, or resulting from securities lending (Standard 5). The standard should set out a clear requirement for these exposures to be appropriately monitored and measured.

Standard 9 on credit risk control focuses heavily on collateralisation as a way to mitigate credit risk. While we agree that collateralisation is a valid way of mitigating credit risk, it is not the only tool available to banks. We recognise that ESCB/CESR has already updated the standard from a "full collateralisation" requirement to one which allows for a portion of the customer credit exposure to be un-collateralised (under very strict conditions). We however, believe

that the ESCB/CESR proposal should be further extended to take into account dynamics between other very important elements in the management of credit risk (defining and monitoring probabilities of default of counterparties, collateral valuation, country risk, legal certainty of collateral contracts, maturity of the exposure, etc), other credit risk mitigation techniques (such as guarantees, letters of credit, credit insurance, etc), and related capital requirements.

We therefore, strongly recommend that ESCB/CESR makes reference to, and builds upon, the existing prudential regulation framework for credit risk management, instead of re-building a similar but not identical framework. The prudential regulation framework is the result of extensive experience in the banking industry and has been practiced over many years. It permits credit institutions (and their regulators) to take into account all relevant risk management elements. Use of this framework would complement the overall objective of increasing collateralisation levels across the industry where appropriate.

### ***Standard 11 - Operational reliability***

As pointed out in the U.S. Interagency Paper on Sound Practices to Strengthen the Resilience of the U. S. Financial System issued in March 2003, “the financial system operates as a network of interrelated markets and participants. The ability of an individual participant to function can have wide-ranging effects beyond its immediate counterparties. Because of the interdependent nature of the U.S. financial markets, all financial firms have a role in improving the overall resilience of the financial system.”

The document recognises that “Core Clearing and Settlement Organizations” not only include market utilities (government-sponsored services or industry-owned organizations) whose primary purpose is to clear and settle transactions for critical markets or transfer large- value wholesale payments, but also those private-sector firms that provide clearing and settlement services that are integral to a critical market (i.e. their aggregate market share is significant enough to present systemic risk in the event of their sudden failure to carry on those activities because there are no viable immediate substitutes).

We believe that a similar reasoning can be applied to the EU financial markets. ESCB/CESR should set strict standards with regard to business continuity plans, back-up facilities and disaster recovery procedures to be applied to all systemically important providers of settlement services.

We believe that the measures to be included in this standard should provide sufficiently stringent assurances of adequate business contingency for systemically important institutions. In this connection, we believe that it is appropriate for systemically important settlement

service providers to establish three data centres each of which should have the processing and storage capacity to process the provider's transaction volumes. There should be full synchronisation of transaction processing between the two 'live' primary data centres at all times; this will allow either of the two primary data centres to take over full operation following a local disaster affecting one of the two data centres. The third centre should be able to take over the complete operational application environment following a regional and/or metropolitan disaster resulting in the failure of both primary data centres. Euroclear has recently announced its plans to develop such a set up, precisely in order to adjust to the new risk environment.

We would also suggest that ESB/CESR gives due consideration to other ways in which operational risk can be mitigated (e.g. insurance, loss sharing provisions, and capital required to cover unexpected losses) Here also, we believe ESCB/CESR could consider the work performed by the Basel Committee for Banking Supervision (BCBS) and the banking community in the area of operational risk management (specifically with regard to "*Sound Practices for the Management and Supervision of Operational Risk*" issued by the BCBS).

#### ***Standard 13 - Governance***

This standard should not seek to decide for the market what the corporate structure and governance arrangements should be, e.g. it should not demand user ownership or governance. While Euroclear firmly believes that user ownership and user governance is the better model for a settlement infrastructure. We also believe that it is for the market to decide whether to insist on such a set-up in individual cases, provided of course that risks are properly controlled. We believe therefore, that ESCB/CESR should remain closer to the original text from CPSS/IOSCO. As pointed out above, we recommend that competition law related notions be removed from the text.

#### ***Standard 17 - Transparency***

We support the requirement set out in Standard 17 at least with regard to transparency of risk exposures and policies. We believe that such elements of this transparency requirement should be extended to all systemically important providers of settlement services (instead of the currently proposed scope of CSDs, CCPs and "custodians with a dominant position" on which we comment below).

#### ***Standard 19 – Risks in cross-system links***

We believe that standard 19 should be removed as the risks it wants to control are already addressed in the related standards on credit and operational risk.

### 3. Response to the consultation questions

In line with the above comments, we answer as follows to the questions in the consultation document on the Scope of Application.

1. *Do you agree that some of the scope of the standards should be extended to systemically important providers of securities clearing and settlement services other than CSDs and CCPs?*

**Yes; a functional approach to regulation of settlement activity is the only way of delivering a fair and competitive playing field for the provision of settlement services.**

2. *Should the extension be to all custodians, or should it be limited to systemically important providers of securities clearing and settlement services?*

**Standards 5, 7, 8, 9, 11 should be applied to all systemically important providers of settlement services. The requirements on transparency of risk exposures and policies in Standard 17 should equally be applied to these institutions. Standards 1 and 12 should be key elements of a regulators approach to any institution which is responsible for client securities.**

3. *What are the criteria along which - according to your opinion - the systemically important system could be defined? What would you consider to be the essential elements that should be a part of such a definition?*

**We agree with the four criteria proposed.**

4. *Do you agree that systemically important providers could be defined as institutions with a business share of [5%] at EU level or [25%] at domestic level (or lower, at the discretion of the national authorities) in each relevant market?*

**We believe that the regulators are best positioned to appraise whether a given institution is a systemically important provider of settlement services, since it is only the regulators that can gain access to the quantitative information from which they can judge whether an institution is systemically important.**

**The criteria used for such categorisation should be transparent. ESCB/CESR should specifically focus on systemically providers of settlement services at a European level, while leaving the regulation of such institutions at national level to national regulation.**



5. *Do you agree that three relevant markets can be considered – bonds (public and private), equities and derivatives – or would a different categorisation be helpful?*

**A broader and more precise definition of markets seems required. There is an increased blurring between different instruments; for example, there are a number of hybrid securities which by definition are neither fixed-income nor equities. The settlement process for securities does not vary much between instruments; i.e., the settlement of a bond or other fixed-income instrument is not that different to the settlement of an equity. However, CSDs and ICSDs are not generally involved directly in the settlement of derivatives which are usually cleared through a Central Counterparty.**

6. *Which of the ESCB-CESR standards should apply to all systemically important custodians?*

**Euroclear believes that the scope of application must be extended to “systemically important providers of settlement services” for all standards which aim to manage and mitigate risks that are potentially of a systemic nature. The risk to be addressed in the provision of settlement services, is mostly linked to:**

- **Credit risk related to customer credit facilities and securities lending (Standards 5 and 9)**
- **Management of operational risks (including requirements of adequate business continuity and disaster recovery arrangements) (Standard 11)**
- **Legal framework (including requirements related to delivery versus payment and settlement finality) (Standards 1, 7 and 8)**
- **Customer asset protection (including processes and procedures ensuring that no securities debit balances are created, no securities creation can take place, and that customer securities can not be used without the customer’s consent) (Standard 12)**

7. *What would be the implications of extending the scope of the standards to cover systemically important providers of securities clearing and settlement services?*

**If applied consistently, the extension of scope will result in increased safety and soundness of the clearing and settlement industry in the EU.**

8. *Do you agree that standards 13, 14, 15 and 17 should apply to custodians with a dominant position in one market? If yes, how would you define a dominant position?*

**No, as indicated before, this refers to competition-related aspects and should not be dealt with by ESCB/CESR.**

#### **4. Ensuring a level playing field**

ESCB/CESR should take the necessary measures to ensure that the interpretation of the standards and the assessment of the compliance with the standards will be applied consistently. We therefore urge ESCB/CESR to determine and to publish more detailed criteria according to which such interpretation and assessment will be performed. The results of the assessments should be made publicly available.

Moreover, to ensure a level playing field between systemically important providers of settlement services, the standards should be applied to all such entities at the same time.

## **5. Relation with other standards applicable to settlement systems**

Today, the CSDs and ICSDs within the Euroclear group are subject to assessment against the CPSS/IOSCO recommendations for securities settlement systems (issued in November 2001) and also in relation to the ECB's "Standards for the use of EU securities settlement systems in ESCB credit operations" (ECB Standards). The Euroclear group believes that the CPSS/IOSCO recommendations should be replaced with the new ESCB/CESR standards once they have been implemented and that the ECB Standards should be made consistent, as necessary, with the ESCB/CESR Standards to ensure that there is a single consistent European regulatory standard for settlement systems.

## Annex 1 – Detailed comments on proposed standards

In addition to the general comments made in the body text of this document, below you will find some more detailed comments.

### **Standard 1 – Legal framework**

Euroclear Group overall welcomes this standard which aims to increase the transparency of the legal framework of providers of clearing and settlement services.

<b>Paragraph</b>	
<b>28</b>	<p>How should we reconcile the statement requiring “laws, rules, procedures and contractual provisions” of each SSS to be “public and accessible” with article 10 paragraph 4 of the Settlement Finality Directive (“SFD”) requiring only to “provide information about the main rules governing “ the system to “anyone with a legitimate interest”?</p> <p><i>We suggest the text of this paragraph be aligned with the SFD.</i></p>
<b>29</b>	<p>Information contained in caption (14) seems less relevant (“rules for the liquidation of positions, including the liquidation of assets pledged or transferred as collateral”) since matters of foreclosure are determined not only by the laws of the jurisdiction where the assets are located (lex rei sitae) and by the rules of the relevant system, but also by the contractual provisions agreed between parties to a collateral arrangement, whether one of them is the settlement operator or not.</p> <p><i>We suggest removing (14) from the list.</i></p>
<b>31</b>	<p>It should be recognised that “custodians operating systemically important systems” (falling into the scope of standard 1) would be able to better comply with standard 1 if they were designated under the SFD.</p> <p>Such entities could apply for such a designation, but would have to meet the conditions applicable under the SFD. In particular, the definition of system under article 2 a) (“common rules and standardised arrangements for the execution of transfer orders” between 3 or more customers – governed by the law of a Member State) operated by an “institution” which may be a bank. Of course, such designation supposes that the competent Member State will have been “satisfied as to the adequacy of the rules of the system” (article 2 a) third indent of the SFD) which implies a review of the operation of the system and its compliance with applicable regulatory standards.</p> <p><i>We suggest that Standard 1 is made more explicit on this topic.</i></p>
<b>32</b>	<p>It is recommended that claims of SSS participants on collateral posted with a system “should in all events have priority over all other claims of such participant’s non-system creditors”. This however, does not depend on the CSD or custodian but is a matter of public and legislative policy, which is not covered by the SFD.</p> <p><i>Standard 1 should be adapted to acknowledge this.</i></p>
<b>33</b>	<p>The reference to the legal soundness of a system being assessed by reference to the “...jurisdiction in which a security handled by the system is issued” is incorrect for indirect holding systems which record securities’ entitlements in a jurisdiction, and under a domestic law, different from the jurisdiction where (or under which law) the underlying securities have been issued.</p> <p>This is confirmed in particular by article 9.2. of the SFD, article 24 of the Winding-Up Directive for credit institutions (“WUD”) and by the Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary” (“Hague Convention”). The last sentence of paragraph 33 (“jurisdictions in which an intermediary, its customer or the customer’s bank is...) seems rather vague and too broad in this context, in view of what is required under main criteria.</p> <p>The requirement in 33 concerning the need to have <i>evaluated</i> the legal framework in all relevant jurisdictions, raises questions:</p> <ol style="list-style-type: none"><li>1. what does ‘evaluated’ mean (is it external or internal legal advice)?</li><li>2. is it really the responsibility of a CSD/CCP to check, certify and publish the full</li></ol>

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enforceability of its legal framework in all jurisdictions where participants are established and in the countries of issuance of all foreign securities held through the CSD/CCP? This would lead potentially to an impossibly expensive task.  
*We suggest reviewing Standard 1 to take into account the above remarks.*

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- 34** We do not understand why in the last sentence it is recommended to have “only one legal system to govern the contractual aspects with SSS participants”; this should be left to basic freedom of contracts and criteria laid down by the Rome Convention on the law applicable to contractual obligations.  
We do not understand why it is also recommended “ideally [that] the law chosen [to govern contractual aspects] should be identical to the law governing the [proprietary aspects of securities holdings in the] system, in order to safeguard systemic finality, certainty and transparency”. The law governing contractual aspects (duties and liabilities of the system’s operator) may be legitimately different from the law governing proprietary aspects of book-entry securities as recognised by the Hague Convention (article 4).  
*We suggest reviewing Standard 1 taking into account the above remarks.*
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### **Standard 2 – Trade confirmation and settlement matching**

Euroclear supports this standard which aims at reducing risks for market participants through early confirmation of trades and matching of settlement instructions.

### **Standard 3 – Settlement cycles**

We fully agree with this standard and its call for harmonisation of settlement cycles, operating days and hours across EU.

### **Standard 4 – Central Counterparties (CCPs)**

As CPSS/IOSCO is conducting analysis on this subject and will come with revised recommendations that will have an important impact on this ECB/CESR standard, we will comment on the revised text of the standard when available.

### **Standard 5 – Securities Lending**

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#### **Paragraph**

#### **74 & 75**

Reference is made to the reduction of securities lending’s exposures by way of “full collateralisation” with reference to corresponding Standard 9. This last standard does not have a strict requirement for full collateralisation but refers to robust risk mitigation measures.  
*We suggest that the wording in Standard 5 be aligned to the one of Standard 9.*

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## **Standard 6 – Central securities depositories (CSDs)**

As indicated in the main text of this response, we propose that the standard is re-named "Safeguarding the integrity of securities issues". The content of this standard should be confined to describing measures to meet this objective. In particular, it should be applied to all entities which are responsible for safeguarding the integrity of a securities issue (CSD, registrar, issuer) and should recognise that in some EU markets (e.g. the UK) the CSD is only responsible for that portion of the issue which is held in electronic form through the CSD. This would re-align the standard to the functional instead of the institutional approach. In this standard, the term CSD should then be replaced throughout the text by "entities responsible for safeguarding the integrity of securities issues."

<b>Paragraph</b>	<b>Standard</b>
	We do not agree with the statement in Standard 6 "CSDs ... should <b>avoid taking risks</b> to the greatest practicable extent" (repeated in key element 4). In performing their core functions, CSDs incur operational risks and may also incur credit risk as a result of exposures deriving from (for example) corporate actions on international securities. Moreover, this statement is not consistent with what is mentioned in paragraphs 77, 78 and 85 where it is stated that CSDs should employ adequate risk mitigation for any risks it incurs. <i>We therefore suggest that ECB/CESR amend the statement as follows "entities responsible for safeguarding the integrity of securities issues should seek to mitigate the risks they incur to the greatest possible extent".</i>
<b>76</b>	We would like to stress the importance of a standard which can accommodate the various practices currently followed by national CSDs and ICSDs in order to meet market needs. We are not convinced that the definition of core activities listed under commentary 76 fits in all circumstances for all European CSDs (specifically the recording of the amount of each issue held in a system in a specific account in the name of the issuer, as proposed under 'a'). <i>We therefore suggest that the list of functions be removed as it does not seem required for the purpose of the standard.</i>
<b>77</b>	This paragraph calls for a closer co-operation between issuer and CSD to preserve the integrity of an issue. This will, however, only work if the total issue is deposited with the CSD and thus reconciliation can take place. Some CSDs does not record the total amount of the issue and may thus not be able to preserve the integrity of the <i>total</i> issue. <i>We suggest that the paragraph be redrafted to take into account the above.</i>
<b>79</b>	As indicated above, we suggest to modify as follows: " <i>In any event, entities responsible for safeguarding the integrity of securities issues should seek to mitigate the risks they incur to the greatest possible extent</i> ".
<b>80</b>	This paragraph states "ultimate owners employ a custodian to reduce risks <u>and safekeeping costs</u> ." It is not clear why employing a custodian would reduce safekeeping costs. <i>We suggest that the last part of the sentence be dropped.</i>  Par 80 refers to "CSD or <u>other depository system</u> ": it is not clear what such "other depository system" would include. <i>We suggest these words be dropped.</i>
<b>81</b>	<i>We would remove the specific reference to broker-dealer and use the generic term "financial institution/intermediary" instead of "custodian". We would also refer to the recording of the legal owner on the register (for registered securities) which can be kept by a different entity (such as a registrar in the UK) outside the relevant CSD.</i>

<b>82</b>	<p>We suggest to drop from the last sentence "Effective governance (see Standard 13) is necessary to ensure that these benefits <u>are not lost as a result of monopolistic behaviour by the operator of the CSD</u>" and replace this by "are passed on to the CSDs' customers" (such benefits can either be reduced costs (direct or indirect), or enhanced service levels).</p> <p>The term "operator of the CSD" is not defined. We suggest that this term be replaced by "CSD".</p>
<b>83</b>	<p>We suggest adding "falsification of securities" as a risk that would disappear in case of full immobilisation or dematerialisation.</p>
<b>84</b>	<p>We would stress that it is up to the public authorities to address this issue as it is out of the control of CSDs.</p> <p>We recommend that the text include the public authority role in this respect.</p>

## **Standard 7 – Delivery versus payment (DVP)**

<b>Paragraph</b>	<p>We recommend that only one definition of DVP be used. Sometimes DVP is explained as "settlement of securities and cash at the same moment" and sometimes as "ensure that the same party does not have control over the securities and the cash at the same time".</p>
<b>87</b>	<p>It should be clarified what is meant by "DVP can and should be achieved for <b>issuance and redemption</b> of securities".</p>
<b>90</b>	<p>This paragraph seems to suggest that each cross-border transaction be processed on a DVP basis, meaning that each link between CSDs will have to be against payment (see par. 92). <i>If this is correct, this requirement should be detailed further. It should also be recognised that this requirement can only be met in case remote access to central banks is allowed.</i></p>
<b>91</b>	<p>This paragraph uses the term "DVP with legal finality". We suggest to modify the sentence as follows: "having achieved DVP with finality at the level of the settlement system, direct participants should credit with finality the accounts of their customers at the earliest on settlement date after having received confirmation from the settlement system."</p>

## **Standard 8 – Timing of settlement finality**

<b>Paragraph</b>	
<b>Key element 3</b>	<p>We would suggest that the following be added: "Payment arrangements and payment systems used for cash settlement of securities transactions should be designed to allow for such intra-day finality". Without such requirement, it may be pointless to require intra-day finality if the cash payment system used only allows for a cash finality at the end of the day, as is still the case in some EU Member States.</p>
<b>94</b>	<p>We recommend complementing the sentence as follows: "The completion of final transfers during the day is essential and must be legally protected in each jurisdiction in the European Union as laid down in the SFD".</p>

<b>96&amp;98</b>	In line with the above comment on key element 3, these paragraphs should take into account that incentives to promote settlement early during the day should not only come from settlement systems but also from payment systems operators and central banks. <i>We suggest therefore, that the addressees of this standard also include central banks.</i>
<b>100</b>	<i>We recommend complementing the sentence as follows: "To guard against this, either the settlement system making the provisional transfer to the linked settlement system should prohibit their retransfer prior to becoming final, <u>unless adequate risk management procedures and controls are in place</u>".</i>

### **Standard 9 – Risk controls in systemically important systems**

We suggest that ECB/CESR includes a clear definition of the credit exposure targeted under this standard and that it makes reference to the prudential regulation framework for credit risk management. Using this framework as a basis for standard 9 will also ensure that the banks to which this standard applies can use their existing credit risk management techniques and tools.

<b>Paragraph Standard</b>	We propose to re-name the standard "Credit risk controls".  Also, the text should more clearly define that credit exposures can result from short-term (even intra-day) credit granted to customers to facilitate settlement of their securities transactions, or resulting from securities lending. It should require appropriate monitoring and measurement of the related exposures.
<b>Key element 3</b>	The texts includes "...operators may offer a <u>marginal</u> amount of uncollateralised credit...".The interpretation of " <u>marginal</u> " should not lead to inconsistent treatment by different regulators, creating an "un-level" playing field between providers of settlement services. <i>We therefore urge ECB/CESR to issue guidelines on the interpretation in the assessment methodology that will be developed.</i>
<b>109</b>	Since paragraph 109 recognises that full collateralisation may not always be possible, we propose to replace everywhere (in particular in the key elements and in paragraph 110) the requirement to "fully collateralise" with the words "adequately collateralise" which seems best to reflect both the reality and the real intention behind the standard.

### **Standard 10 – Cash settlement assets**

Standard 10 should also include central banks as addressees since the main recommendations affect central banks or need their support to be achieved.

<b>Paragraph Key elements</b>	<i>The text should recognise more clearly that the use of central bank money is not always an option, e.g. cross-border DvP links can typically not be settled in central bank money because this would require remote access to central banks.</i>
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## **Standard 11 – Operational reliability**

<b>Paragraph Standard</b>	<i>We propose to change the wording of the first sentence as follows: Sources of operational risk arising in the clearing and settlement process should be <u>regularly identified, assessed and monitored</u>.</i>
<b>Key element 3</b>	<i>We suggest adding (in line with par 126): <u>Senior management should have the responsibility for implementing changes to the risk strategy approved by the board of directors.</u></i>
<b>Key elements 6 and 7 as well as par 133</b>	Statements on outsourcing should be further clarified. We interpret the current text which reads that outsourcing agreements are subject to prior approval "where applicable", to mean "if required under the applicable regulatory regime". It is unclear therefore, what will be required for "further outsourcing" for which paragraph 133 seems to require in all cases prior approval of the subsequent outsourcing. Secondly, compliance of the external provider with "these standards" should only be required for those ESCB-CSER standards which are relevant in view of the nature and the scope of the outsourcing. We therefore, suggest to add the words "to the extent relevant" after "the external provider meets the standards".
<b>126 or 127</b>	<i>We suggest to add that the institution should endeavour to comply with the principles set forth in the "Sound practices for the Management and Supervision of Operational Risk" document issued by the Basel Committee for Banking Supervision.</i>
<b>130</b>	The standard foresees that systemically important providers of settlement services need two processing sites. We believe that adequate business contingency and disaster recovery arrangements should foresee three processing sites (see above).
<b>132</b>	<i>We suggest that ECB/CESR complements this paragraph as follows: "the regulators and supervisors of systemically important providers of settlement services should encourage these providers to set up a plan for industry-wide contingency planning ensuring that interoperability between such institutions can be ensured".</i>

## **Standard 12 – Protection of customers' securities**

<b>Paragraph</b>	<i>We propose to replace the term "customer securities" by "customer entitlements" or "customer assets".</i>
<b>Key element 7</b>	<i>We recommend modifying the sentence as follows: "In no case should <u>securities</u> debit balances ...be allowed..."</i>
<b>137</b>	Segregation between own assets of the (I)CSD and participants' securities by way of two separate accounts with the Issuer CSD (instead of one omnibus account encompassing both types of positions) may also be replaced by a statutory regime allowing customers of the CSD (or of any intermediary participating in such CSD) to recover their property rights on the own assets of the CSD/intermediary. Customers can use this right in case there is a securities shortfall with such CSD/intermediary with the result that securities holders could not recover entirely their rights on the amount of securities available in their respective accounts. This is the case in Belgium under Articles 9 and 10 of Royal Decree n° 62. <i>We recommend that the paragraph also take into account this alternative.</i>
<b>137, 138 &amp; 139</b>	The explanatory memorandum is unclear on the status of segregation. It is not clear whether segregation is viewed as <u>one</u> way to protect customers' securities (which we feel is the correct analysis) or whether it is regarded as the <u>only way</u> and/or as a "requirement" (see par. 139). In this last case, such requirement to segregate each individual customer position at the level of the issuer CSD, or even (as mentioned in par 139) "at every level" of the custody chain, would paralyse cross-border securities settlement. Indeed, it would oblige CSDs and providers of settlement services to abandon the benefits of internalisation in order

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to debit and credit respectively the account of each individual customer concerned by a transfer with the costs, delays and settlement inefficiencies associated to this practice.

We are confident however that this could not be the aim of such explanatory comments (which should therefore be revisited). In reality, protection of customers assets (when re-deposited with another intermediary or with the issuer CSD) should be ensured (as mentioned in paragraphs 143 and 144) by obliging the custodian to check the nature of the rights (property or claims; mere reference to "entitlement" as such is misleading since some securities entitlements as those organised in the US, Luxembourg or in Belgium qualify as true (co-) ownership rights) granted by sub-custodian/issuer CSD 's legislation to make sure that – in case of insolvency of the latter – underlying securities may be recovered in kind by the depositing custodian on behalf of its customer. These customers will exercise their rights against their custodian according to the law governing the proprietary aspects of the securities holding. This should be complemented by the use of appropriate (sub-) custody agreements ensuring adequate level of segregation between the customer assets of the depositing custodian (the "omnibus account" of the investor CSD) on the one hand and the own customers' assets of the sub-custodian on the other hand.  
*We recommend that the text is amended to reflect the above*

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**Par. 141 and key element 6** Use of customer assets for securing either own transactions of the intermediary/custodian or transactions of other customers should be authorised indeed upon customer's consent *but under the conditions laid down in applicable legislation.*  
*We suggest adding this last text.*

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### **Standard 13 – Governance**

*Comments related to standards 13, 14, 15 and 17*

As explained in the main text, we recommend that all references to "custodians with a dominant position" be removed from Standards 13, 14, 15 and 17.

There are inconsistencies between the content of the key elements and the explanatory memorandum. The explanatory memorandum (par 148) states that user representation should be achieved - a concept which Euroclear supports - but the key elements do not include this notion.

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#### **Paragraph**

**148** The text includes: "user representation should be achieved, inter alia, through consultation mechanisms ideally drawing on key users, including small and retail investors and full account should be taken of their views." It should be recognised that it is impossible to take fully into account the views of all users. This would lead to inertia and would hamper innovation.  
*If the text is maintained, we recommend that the word "full" be removed.*

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### **Standard 14 – Access**

Overall comment on Standard 14: there are inconsistencies between the content of the key elements and the explanatory memorandum; the explanatory memorandum includes

requirements which are much more demanding with regard to refusal of access than the key elements.

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<b>Paragraph</b>	
<b>155</b>	The text mentions the need for an appeals procedure that is independent of the CSD. Euroclear foresees appeal possibility at Board level. We judge this is adequate because Euroclear is a user-owned, user-governed institution. Having a completely separate and independent appeal procedure seems very complex, a complexity not warranted seen the very few access refusals that take place. <i>We suggest that the text be amended to take into account the above.</i>
<b>156</b>	<i>As explained above, we recommend that this paragraph be dropped.</i>
<b>157</b>	<i>As explained above, we recommend that references to competition law concepts such as granting access be avoided or reworded.</i>
<b>160</b>	"In case of insolvency of a custodian, securities accounts should be transferred to another entity..." <ul style="list-style-type: none"><li>➤ This is a matter of direct relationship between the investor and his custodian or settlement agent, hence the CSDs/ICSDs cannot have automatic procedure for the designation of another custodian.</li><li>➤ Under certain circumstances, the clients' securities may have been pledged (with his explicit approval) to a designated counterparty, including the ICSD itself (for example as collateral backing up a credit line).</li></ul> <i>We suggest that the text be redrafted to include the above and to avoid the confusion created by using the term custodian to mean an entity other than the settlement provider</i>  "Exit procedures should be publicly disclosed". Termination of a contract may result from non-compliance with the access criteria. <i>We see no added value in having exit procedures publicly disclosed and therefore, propose to remove this sentence from the text.</i>

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### **Standard 15 – Efficiency**

We believe that efficiency as described in this standard can not be achieved just through efforts by CSDs, CCPs and providers of settlement services. Indeed, as identified by the two Giovannini Reports, some measures will need the intervention by public authorities and national governments. This should be clearly recognised in the text of the standard, the key elements and the explanatory memorandum.

### **Standard 16 – Communication procedures, messaging standards and straight-through processing**

While we fully agree with the objective and content of this standard, the standard should recognise that achieving standardised messaging and reference standards and high levels of STP requires substantial investment from providers of clearing and settlement services and from communication services as well as customers. The assessment of compliance with this standard will need to take into account that the decision to invest in increased STP depends on customer demand and available resources.

### **Standard 17 – Transparency**

We fully agree with this standard on transparency of costs and risks. We recommend that ECB/CESR makes a reference to the market discipline required under Pillar 3 of the Basel II framework. Indeed, this latter framework already requests significant disclosures.

Disclosure requirements on risk exposures and policies should be applied to all systemically important providers of settlement services instead of the proposed scope of application.

### **Standard 18 – Regulation, supervision and oversight**

We welcome this standard, specifically paragraphs 194 to 198 on the co-ordination between regulatory authorities in a cross-border environment. We particularly applaud the fact that ECB/CESR recognises the need for transparent, consistent and effective regulation and oversight. From a Euroclear group perspective, it is indeed critical that the following principles are taken into account:

- I. Strong supervision/oversight of (I)CSDs and operators of systemically settlement important systems has always been regarded as necessary for the successful development of European financial markets.
- II. In order to avoid duplicate (or conflicting) requirements, regulatory/oversight gaps and unnecessary costs, the co-ordinated supervision of (I)CSDs and other systemically important providers, should in our view provide for a regulatory “single-entry point” in order to allow in particular each institution to have one single lead-regulator through which all information requests or queries from other relevant regulators may pass, under the regulatory regime applicable in the lead supervisory authority/overseer’s jurisdiction.
- III. The substance of the bilateral/multilateral arrangements (MOU) between regulators concerning CSDs should be disclosed to them in order to be able to operate in a predictable environment and to act in a manner that is consistent with applicable regulatory policies.
- IV. Exchange of information between the lead-overseer/supervisor and other interested regulators should concern information relevant to the respective domestic market or domestic supervised institutions of the latter.
- V. Applicable supervisory framework should not lead to delays in CSD decision-making process, in view of the highly competitive and fast-changing environment of the securities industry which often requires quick decisions with respect to settlement platform development, admittance of participants, eligibility of new securities or currencies, rules of the system, fees structure, IT developments, etc.

### **Standard 19 – Risks in cross-system links**

In our view, risks linked to cross-system links are either credit or operational risks. Since these risks and their mitigation are covered in Standards 9 and 11, we see no added value in having a specific standard for these links. *We recommend therefore, that Standard 19 be dropped and that the other relevant standards include references to such "links".*