EUROPEAN CENTRAL BANK

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JOINT WORK OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS IN THE FIELD OF CLEARING AND SETTLEMENT

A CALL FOR CONTRIBUTIONS FROM INTERESTED PARTIES

The collaboration project between the Committee of European Securities Regulators (CESR) and the European System of Central Banks (ESCB) (collectively the "Group") in the field of securities clearing and settlement was announced in a joint press release by the European Central Bank (ECB) and the CESR on 25 October 2001 (see Annex 1). This paper explains in greater detail how the Group's work will be conducted and invites interested parties to provide input for it.

The Group commenced its work with meetings in November 2001 and January 2002. It is being supported in its discussions by a drafting group drawn from the participating institutions. At this stage of its work, the Group is particularly interested in receiving views on some of the more detailed issues set out below.

The work of the Group should be viewed in the context of the overall efforts by public authorities to ensure the efficient and proper functioning of securities clearing and settlement arrangements. The interest of central banks arises from the relevance of these arrangements for the smooth execution of monetary policy, the correct functioning of payment systems and financial stability. Securities regulators are interested in maintaining confidence in the safety and reliability of systems in order to maintain market efficiency and ensure investor protection.

The European Commission will issue a communication on this subject in the coming weeks, which will set out its policy objectives and call for input from interested parties as to the appropriate action to be taken. The communication will consider such issues as how to remove obstacles to create more efficient systems, how to establish a level playing field for these activities, and the need for an overall EU legal framework. The work of this Group, in which the European Commission participates as an

observer, complements the Commission's approach and will provide it with important feedback on the form of any intervention that may be needed in this area.

1. The Group's approach

At its first meeting, the Group decided to commence work on the following:

- The possible adaptation of the CPSS/IOSCO "Recommendations for Securities Settlement Systems" to European environment.[1] It was recognised from the outset that the CPSS/IOSCO recommendations represent an obvious starting point for any work to be undertaken on the issue of setting standards for securities clearing and settlement. However, given their fairly broad scope, it would appear necessary to examine each of these recommendations with a view to identifying whether there is a need for deepening and strengthening the underlying criteria for application in the European context.

- An analysis of central counterparties (CCPs) clearing activities in Europe with a view to identifying a suitable regulatory approach. CCP activity had not been the subject of in-depth consideration in the elaboration of the CPSS/IOSCO recommendations. The work in this field will take note of the standards prepared by the European Association of Central Counterparty Clearinghouses (EACH).[2]

- A review of the report of the Giovannini Group entitled "Cross-border clearing and settlement arrangements in the European Union"[3], with a view to identifying any contribution by the Group to reduce the barriers to the further integration of the European securities clearing and settlement infrastructure identified in the report.

The Group's work will also take into account a number of other papers on the issue of clearing and settlement, in particular the "Standards for the use of EU securities settlement systems in ESCB credit operations".[4]

2. Issues for further consideration

The issues listed below have been touched upon in the Group's discussions. As such, they do not represent an exhaustive list of topics to be examined, rather they are indicative of the breadth of issues for discussion and intend to serve merely as a starting point for future debate.

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1 http://www.iosco.org/download/pdf/2001-securities_settlement_systems.pdf
2 http://www.eachgroup.org/pdf/2050gb%20STANDARDS%20-%20NOVEMBER%2001.pdf
3 http://europa.eu.int/comm/economy_finance/publications/giovannini/clearing1101_en.pdf
4 http://www.ecb.int/emi/pub/pdf/sssstandards1998.pdf

2.1 Nature of the recommendations: What should be the legal nature of the recommendations and/or standards to be issued by the Group? Are there issues for which a European legal instrument is deemed appropriate? Are there recommendations and standards that should be adopted by national law?

2.2 Addressee: Who is the appropriate addressee of the possible standards or recommendations to be drawn up by the Group: the regulators, the systems, the operators or the users? In such cases where standards and/or recommendations are addressed neither to regulators nor to legislators, what are the appropriate incentives for their implementation and compliance?

2.3 Scope: Do you agree that the scope of the Group's work includes any entity providing clearing and settlement services or associated aspects and is not limited to any particular type of service provider? More specifically, do you agree that central securities depositories (CSDs), international central securities depositories (ICSDs), CCPs, custodians and registrars are included? Do you think that some standards should apply on a differentiated basis to these parties given that the scope of their business is not directly comparable? Should standards apply to other parties? If so, which standards and to which parties? With regard to custody and safekeeping services, what are the advantages or disadvantages of a distinction being drawn between custody services, on the one hand, and clearing and settlement on the other? Do particular considerations apply where custody and safekeeping services are provided by credit institutions or investment services firms? With regard to the securities covered, do you agree that sovereign and private debt, equity and other securities, as well as depository certificates, receipts, derivatives, etc., are included, or where would differentiation be necessary? Should some standards/recommendations be specifically addressed to cross-border transactions? If so, which ones?

2.4 Objectives: A priori, the objectives of central banks and securities regulators in the field of securities clearing and settlement systems could be summarised as follows: 1) risk mitigation, including investor protection, for both the system and the users; 2) efficiency, including for cross-border activities; 3) creation of a level playing field between participants and service providers, irrespective of their legal status or their geographical location; 4) promotion of integration of the EU securities markets infrastructure. Do you agree? Do you consider that these objectives are sufficient?

2.5 Access conditions: Are you aware of access conditions to specific service providers which could be considered discriminatory? If so, where do the main problems lie? Do you consider that the present rules do/do not establish a level playing field in this respect? Do they relate to the access criteria of the system or to other conditions such as operational features? If so, which ones?

2.6 Risks and weaknesses: What are the most relevant factors to risks and weaknesses in terms of clearing and settlement of domestic and cross-border transactions (i.e. legal, settlement, custody and operational risks)?

As far as legal risks are concerned, what kind of problems can different legal approaches create? When looking in particular at cross-border transactions, how does the existence of different jurisdictions and the involvement of several actors such as local agents, global custodians, foreign CSDs or ICSDs in the process of cross-border clearing and settlement affect the nature and magnitude of these risks? What would be the most appropriate manner of addressing these issues?

As far as custody activities are concerned, do you agree that the segregation of assets and the reconciliation of positions are the most crucial issues to be addressed?

As far as settlement risk is concerned, do you agree that the definition and timing of finality (including the need for intraday settlement finality), delivery versus payment, access to central bank money as settlement assets for systemically important systems and conditions of use of central bank money versus commercial bank money are the most crucial issues to be addressed with regard to clearing and settlement of domestic transactions? What specific impact could these issues have on clearing and settlement of cross-border transactions?

Finally, as far as operational risks are concerned, what are the main factors to be considered?

2.7 Settlement cycles: What are the arguments for and against harmonised and/or shorter settlement cycles? It appears, for instance, that while a very short cycle could increase settlement default rates, a longer cycle could increase uncertainty and settlement risk. Is there a need to adopt different settlement cycles for different securities, such as for equities and government debt instruments, etc?

2.8 Structural issues: The structure of the securities clearing and settlement industry in Europe has been hotly debated recently. An integrated market can be achieved via a number of routes, with concentration, interoperability and open access being the most obvious alternatives. What are the arguments, if any, for a public policy intervention relating to (i) centralised or decentralised structures for infrastructure and service providers; and (ii) the governance structure of infrastructure and service providers? Are custodians, CCPs, CSDs and ICSDs to be considered as commercial firms, driven by regular competition, or should they (or some categories of these entities) be considered as utilities whether or not they operate within a monopoly environment? Does the same reasoning apply to the provider of trading services?

3. Call for contributions

This paper is designed to encourage interested parties to provide input to the Group's work and has been distributed via the ECB and CESR websites, as well as the websites of the national central banks and CESR members. All input should be sent jointly to the Group's rapporteurs, Elias Kazarian, ECB, and Christoph Crüwell, CESR, via e-mail: elias.kazarian@ecb.int and secretariat@europefesco.org. Contributions should ideally be received before 6 May 2002. All contributions received will be made public, including on the internet, unless it is clearly indicated that the author does not consent to such publication.

The Group is committed to a full public consultation of any work produced in accordance with the CESR's "Public Statement on Consultation Practices" (CESR/01-007c) and the current consultation practices of the ECB. This paper demonstrates the importance given to the input of interested parties at an early stage of the work process. Proposals made by the Group will be submitted to the CESR and to the Governing and General Councils of the ECB. The proposals of the Group will also be discussed with other supervisors and in particular with the ECB's Banking Supervision Committee (BSC).

The Group appreciates the importance of receiving informed input from all interested parties, such as clearing and settlement service providers, intermediaries, banks, investment services firms, issuers, institutional investors, industry and trade associations, and especially from consumer and retail investor organisations. Even though it is recognised that consumers and retail investors may have little appreciation of the impact of securities clearing and settlement arrangements on their transactions and financial position, the Group nevertheless believes that it is important to hear the end-user's voice at an early stage of its work. The rapporteurs will be happy to be of assistance to any interested group where technical matters are concerned (please see contact details above).

ANNEX 1

PRESS RELEASE

Joint work between the CESR and the ECB on securities clearing and settlement systems

Paris/Frankfurt am Main, 25 October 2001

The Governing Council of the European Central Bank (ECB) and the Committee of European Securities Regulators (CESR) agreed to conduct joint work on issues of common interest in the field of securities clearing and settlement systems.

A framework for co-operation in the field of securities clearing and settlement systems was approved by the Governing Council of the ECB and the CESR. It sets out a procedure to conduct this joint work.

A *Working Group*, composed of representatives of the ECB and the 15 EU national central banks and representatives of the CESR, will start its work in the near future. Mr. Jean-Michel Godeffroy, Director General of the ECB, and Prof. Eddy Wymeersch, Chairman of the Belgian Commission Bancaire et Financière, will co-chair the Group.

This process will lead to the establishment of standards and/or recommendations for securities settlement systems and for central counterparties at the European level.

Common standards will contribute to creating a level playing-field for the providers of securities clearing and settlement services and to overcoming the significant heterogeneity within the legislative frameworks of European countries.

The fruitful experience of the Joint Task Force of the Committee on Payment and Settlement Systems (CPSS) of the G10 central banks and the International Organization of Securities Commissions (IOSCO) encourages co-operation at the European level between central banks and securities regulators in this field. The CPSS-IOSCO recommendations represent a valid starting-point for assessing the need to adopt more stringent recommendations at the EU level.

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Notes for editors:

The CESR was established as an independent committee of European securities regulators. All undertakings, standards, commitments and work agreed within the Forum of European Securities Commissions (FESCO) will be taken over by the CESR. The role of this Committee is to:

- improve co-ordination among securities regulators;
- act as an advisory group to assist the European Commission, in particular in its preparation of draft implementing measures in the field of securities; and
- work to ensure more consistent and timely day-to-day implementation of Community legislation in the Member States.

The Committee was established under the terms of the European Commission's decision of 6 June 2001 (2001/1501/EC). It is one of the two committees envisaged in the final report of the Committee of Wise Men on the regulation of European securities markets. Baron Alexandre Lamfalussy chaired this group. The report itself was endorsed by the Stockholm European Council Resolution.

Each Member State of the European Union has one member on the Committee. The members are nominated by the Member States and are the heads of the national public authorities competent in the field of securities. The European Commission has nominated John Mogg, Director General of the Internal Market DG, as its representative. Furthermore, securities authorities of Norway and Iceland are also represented, at a senior level.

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