To: Elias Kazarian, The European Central Bank
Christoph Crüwell, The Committee of European Securities Regulators

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

We are pleased to have the opportunity to provide you with input on the issues surrounding the further development of clearing and settlement in Europe.

As an international investment bank, fund manager and retail broker we are major users of European clearing and settlement infrastructure and have a keen interest in contributing fully to the debate.

We have shared the views contained in the attached note with the London Investment Banking Association, the British Bankers Association, the European Bankers Association, the Financial Services Authority and the Bank of England.

Barclays PLC
6 May 2002

BARCLAYS

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

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Executive Summary

- The existing clearing and settlement processes in Europe are reasonably efficient in isolation, however, from a cross-border perspective, fragmentation makes the whole unnecessarily inefficient.

- Our overriding concern is that we have safe and efficient clearing and settlement processes (capable of supporting long-term growth) to support a competitive pan-European capital market.

- Although much has been said and written about the need to rationalise and improve the process, little has actually been achieved.

- The absence of an agreed vision of the necessary infrastructural, legal, fiscal and regulatory change and, most importantly, the way to achieve that vision results in inertia, and vulnerability where those involved continue to commit scarce technical resources to support developments across multiple external systems.

- We believe that the core processes of clearing and settlement are natural monopolies that should be owned and governed by the users.

- Access should be open, equitable and transparent. Those that wish to use intermediaries should be free to do so.

- The operational design of the clearing and settlement utilities will require much careful thought to balance risk and cost.

- Added value services should be open to the full forces of competition.

- More than anything the markets must avoid embedding the inefficiencies of yesterday's approach to European clearing and settlement yet further into their systems.

- We welcome regulatory attention in this area, as there are 3 key areas where only public sector intervention can remove barriers to consolidation:

  - Harmonisation of securities law such that a market participant can easily determine their rights with certainty. A market participant's claim on its securities and any associated benefits must be beyond challenge. That certainty should not be diminished through the use of intermediaries, e.g. custodians. The process of enforcing those rights must be clear and unambiguous. The point of settlement finality for both securities and funds must be obvious and universal.

  - A harmonised process of tax reclamation that minimises the administrative costs to the underlying owners, investment managers, broker dealers, global custodians and the fiscal authorities.

  - A common and proportionate regulatory framework

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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?

With consolidated infrastructure the range and roles of the current actors are unlikely to remain extant. Regulatory intervention should focus on what is appropriate and proportionate for the future model rather than diverting resources to address historical structures.

At this stage it is difficult to be prescriptive about the full range of necessary change; much will depend on the chosen settlement model. What we can say with certainty is that the clearing and settlement process would benefit from:

- Harmonisation of securities law such that a market participant can easily determine their rights with certainty. A market participant's claim on its securities and any associated benefits must be beyond challenge. That certainty should not be diminished through the use of intermediaries, e.g. custodians. The process of enforcing those rights must be clear and unambiguous. The point of settlement finality for both securities and funds must be obvious and universal.

- A harmonised process of tax reclamation that minimises the administrative costs to the underlying owners, investment managers, broker dealers, global custodians and the fiscal authorities.

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In addition we believe that there would be great value in the public sector taking this initial opportunity to set out its views on the failings of today's arrangements, the range of infrastructural choice and the public policy issues associated with each.

A Communication on the above points should not only inform the markets' discussions, but also provide a clear impetus and timeframe for moving forward.

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?

The addressees should be determined by mapping the elements of any communication on the future clearing and settlement model to those affected.

That "roadmap" should explain why intervention is required, state the recommendation or standard and how it addresses the problem identified, the expected action, the addressee and deadline for implementation.

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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?

To the extent that regulatory intervention is required the level of change should be as little as is commensurate with attaining the intended objectives.

As added value services should be subject to the full forces of competition, the provisions of existing competition law should suffice in that arena.

There may be areas of operation where infrastructure providers are in competition with financial institutions, for example, custody services. In that instance the infrastructure provider should be regulated or otherwise in relation to those activities on the same basis as any other commercial provider.

Regulatory intervention should be risk-based and should not stifle innovation nor create further inefficiencies, for example by unnecessarily proscribing certain classes of instrument.

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 crossborder 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?

Taken as a whole, we support the stated objectives. We are less convinced that they can be given relative priorities.

For example, if risk mitigation was the primary concern, an extreme approach to squeezing risk from the clearing and settlement process could compromise efficiency to such an extent that only the richest could play through national silos.

Instead we see a requirement for central banks, securities regulators and participants to take a holistic view.

Access conditions

The functional design of the clearing and settlement systems best suited to support an integrated and efficient single, pan-European capital market will determine the appropriate 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?

We believe that instances of discriminatory access tend to be a result of legitimate, historic efforts to ensure stability at the domestic level, for example, requirements that settlement is effected only through locally incorporated banks, or that a particular security can only settle in one system.

The justification for that type of discriminatory access condition looks less appropriate in the context of increased cross-border activity and the desire to create an efficient, single pan-European capital market.

If the current infrastructure model was likely to remain intact then one response might be for the DG Competition to require each service provider to review its access conditions and justify apparently discriminatory requirements. However, as the model is likely to change, such an approach could lead to a distracting and costly exercise to solve a problem that arises through the infrastructure we have rather than the infrastructure we need. We want to avoid initiatives that require yet more duplication of effort and prolong the current fragmentation of European clearing and settlement. At a practical level we suspect that removing any discriminatory access conditions would result in few participants changing their approach to clearing and settlement in the short-term. The markets have devised "workarounds" to any perceived barriers and are likely to want to realise the benefit of those investments before making any significant changes.

We would suggest that a better approach would be to determine the clearing and settlement infrastructure best suited to support an integrated and efficient single pan-European capital market. Thereafter to drive out the appropriate access arrangements. As a general principle, we believe that access to core clearing and settlement processes should be open, equitable and transparent. Those that wish to use intermediaries to access those core services should be free to do so.

Risks and weaknesses

Intervention that harmonised legal, fiscal and regulatory practices (but without affecting the economic characteristics of the underlying assets) would facilitate the creation of a single settlement utility and would remove the distinction between domestic and foreign settlement. The choice of settlement asset would need to balance credit risk against liquidity costs, where the powerful netting effect of a single central counterparty could mitigate against the choice of commercial bank credit.

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)?

The risks and weaknesses that exist are inherent in the use of multiple domestic approaches to clearing and settlement in an international context. For example, in a purely domestic market the application of the local law would make perfect sense because it is that law that governs all residents in that country. Introduce participants from other countries and immediately the potential for conflict arises. Similarly, within a purely domestic market, while there may be "barriers to entry" these are likely to be for good reasons, for example, there might be an historic requirement that all settlement must be effected through banks incorporated and resident in a given country to ensure domestic financial stability. An overseas bank (of equal or better financial standing to the weakest local bank) that wished to trade and settle in that market might reasonably consider themselves disadvantaged if they had to employ a local intermediary.

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?

Cross-border settlement is inefficient and risky. A participant has either to maintain a settlement relationship with foreign CSDs (or employ a settlement agent, etc.) or use the tortuous against payment mechanisms devised by linked CSDs. The former adds cost, not just in terms of fees paid to multiple CSDs, but also in the complexity of the participant's back office, jurisdictional issues, fragmented cash funding, differing qualities of settlement, etc. The latter is a complex process in which the selling participant loses control of its stock, takes risk against CSDs (that may have little capital or limited liabilities) and waits until the required payment materialises through external payment mechanisms. Furthermore, as the CSD links are based on the security in question remaining in the home depository, the title acquired by the participant in the foreign depository is less obvious, that in turn can impact the efficiency of corporate action processing.

The physical domicile of the CCP and CSD and choice of law should be of supreme indifference to the users, provided that the legal and fiscal arrangements are such that everyone acquires "good" title to the

assets in question. Harmonised legal arrangements would be a major contribution towards eventual systems integration.

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?

The segregation of assets and the timely reconciliation of positions are of paramount importance.

It is worth noting that if we can move to a single pan-European CCP and CSD the role of custodians might well change. Today they intermediate in the process of settlement because the infrastructure is fragmented and "alien". In a consolidated model, the process would be identical for each transaction/class of asset, so no longer alien and only one connection would be required. In turn that might lead to custodians evolving their business model to concentrate on providing added value services. Some participants might still want to outsource their settlement activity and should be free to do so, but overall efficiency should be improved.

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?

The effective management of settlement risk is not straightforward. Either central bank money or commercial bank credit can be an acceptable settlement asset; both have advantages and disadvantages viewed from either an efficiency or risk perspective. The design requirements of the underlying systems will in large part determine what the settlement asset should be, quite possibly, a hybrid model. However, as an overriding principle, the settlement asset should carry little or no credit or liquidity risk. If central bank money is not used, steps must be taken to protect participants in securities settlement systems from potential losses and liquidity pressures arising from the failure of the cash settlement agent whose assets are used for that purpose (CPSS-IOSCO Recommendation10). In addition to capital adequacy requirements, commercial banks involved in the securities settlement process should have appropriate and enforced risk management procedures and access to adequate intra-day payment capacity in relevant payment systems (that adhere to the Core Principles for Systemically Important Payment Systems) to allow for the timely transfer of settlement proceeds.

It must be remembered that in addition to credit risk, settlement risk has a liquidity component. Whilst simultaneous and final delivery versus payment in central bank money is a powerful tool to reduce systemic settlement risk, the attendant liquidity demand must be capable of economic supply. In a model where there was a single settlement utility it should be possible to accommodate both central bank and commercial bank money as the settlement asset, where interaction with the netting capabilities of a single central counterparty could balance the credit risk associated with commercial bank money against the liquidity cost of central bank money.

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

With the consolidated model we propose some might argue that the resultant concentration of operational risk would be unwelcome. The alternative view is that consolidation will make it easier to manage operational risk as management would be common. We believe that the greater operational risk surrounds the interaction of clearing and settlement infrastructure with RTGS payment systems and the CLS Bank, a subject addressed in more detail in our comments on "Structural Issues".

Settlement cycles

Harmonised standard settlement cycles could be beneficial as it would make it easier to synchronise the reinvestment of funds across markets – and if coupled to a single pan-European multi-currency, multi-product CCP (see Structural issues below) should minimise margin requirements (subject to relative volatility) and could lead to minimal cashflow at settlement – vis a contract for differences.

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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?

The paper asks for views on shorter settlement cycles, but does not give any reference point. For the purpose of this note we have assumed that the primary interest is in equities, that today's standard settlement cycle is T+3, applies to dematerialised securities held in a CSD/settlement system and that the target is a T+1 environment. For fixed income we believe that T+0 and/or T+1 is already typical.

The argument in favour of moving to T+1 is to reduce market risk, but we do not believe that you can look at the question of reduced equity settlement cycles in isolation from the other components of clearing and settlement. For example, in a T+3 model where there is a properly organised and managed CCP, a CSD operating BIS Model 1 DvP in central bank money in a market with an effective stock lending capability, it is difficult to see what risk reduction benefits a reduced settlement cycle would bring. A T+1 environment would look to pose challenges for central counterparties around when they call for margin. To do so in real time would be inefficient with payments flying back and forth. Collecting at the close of business would require alignment with the cash markets. By the following day risks settlement occurring before margin is paid.

We know that when markets moved from T+5 to T+3 it was not overly problematical – it was more a case of doing the same things quicker rather than a change in underlying processes. It is accepted that that would not be the case for a move to, say T+1 – the work of the SIA in the United States demonstrates the high level of system and behavioural change necessary. Although T+0 and/or T+1 have been achieved in fixed income markets, the volumes relative to equities are low. To achieve T+1 for equities would require a significant level of investment to achieve error free straight through processing or risk a high level of fails. Although stock lending activity could address failed trades, we would see that as papering over the cracks.

It seems to us that any benefit of T+1 for equities will be asymmetrical. Fund managers look likely to see increased costs for little return. In any market contemplating a T+1 standard settlement cycle we would expect to see a coherent explanation of the risk removed. The analysis of cost and benefit distribution would have to take into account the current infrastructure of that market, but also the likelihood of consolidated European settlement infrastructure (and what model that might be based upon).

Foreign exchange processing and the availability of RTGS payment systems will also need to be factored in to the equation to ensure funds were in the right place at the right time.

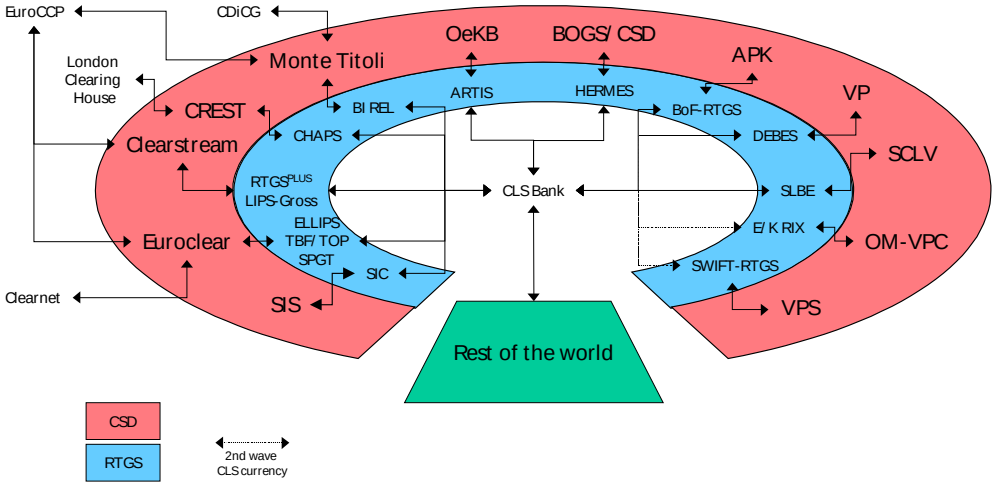
Paper based equity settlement presents logistical problems in anything much less than a T+10 environment. Short of public sector action to require the dematerialisation of all securities, removing paper (typically concentrated in the hands of retail investors) will be difficult and protracted, especially where the result is increased costs to the retail investor.

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?

To assess whether there is a structural problem with European clearing and settlement infrastructure, our starting point is to look at the "wiring diagram".

In the schematic below it can be seen that CCP, CSD and RTGS systems evolved at the national level. Until recently CCPs have tended to serve their local market, but some evidence of international coverage has started to emerge. Some CSDs have developed direct links with other CSDs. In other cases custodians facilitate indirect access. The majority of the RTGS systems are linked together through TARGET and later this year CLS will provide real-time links to other RTGS systems around the globe.



This schematic is of course a very simple view of the infrastructural arrangements and ignores the myriad links to stock exchanges/trading systems, investors, custodians (and through custodians the world beyond), broker dealers, and payment banks.

What it does highlight though is that at the clearing and settlement level there has been significant investment in the old national "silos" (that operate to differing operational standards/practices and laws).

It is perfectly understandable that the owners and users (who have had to build multiple system interfaces in their own systems) of clearing and settlement infrastructure would want to realise the value of their sunk investments. Equally, it was necessary for the service providers establish links with each other to facilitate the movement of collateral around the eurozone. However, the question that must be answered is whether this evolved model is appropriate to support a single pan-European capital market?

We would say no:

This plumbing exists solely to support financial markets, ergo the process of clearing and settlement must primarily be safe, but otherwise should be at the lowest possible cost that in turn implies that unnecessary duplication of effort should be avoided.

Competition between CCPs would be undesirable as it could lead to a diminution in risk management. As the maximum benefits of netting will be seen from the use of a single supplier we would say that there should be a single pan-European multi-currency central counterparty covering all categories of asset, owned and governed by its users. There would be merit in the public sector setting out its position in this area as it may then avoid unnecessary and undesirable creation of yet more domestic CCPs. The domicile and contractual legal jurisdiction of the single CCP is less important than the absolute requirement that the legal foundations are correct and that the risk management processes are first-rate.

In the so-called "hourglass" model a single CCP would span multiple CSDs. If those CSDs are linked such that some participants can then elect to hold, say a UK security via Euroclear and others directly

with CRESTCo, systemic risk and pricing issues will arise. Firstly, with today's infrastructure, cross-border delivery versus payment – the simultaneous and final exchange of securities and funds - is not possible. Typically the seller loses control of his security and waits whilst the buyer (via the CSDs and TARGET) remits funds. Interposing a CCP adds further layers and cost and begs the question of how the CCP will finance settlements across CSDs. For example, if each CSD operates a delivery versus payment environment, the central counterparty will not be able to take securities from the seller without paying for them, but the ultimate buyer will not pay until the securities are delivered. How then would the central counterparty bridge the funding gap? Secondly, pricing will be an issue from the perspective that a potential buyer will not know where the seller intends to settle and therefore the costs he will incur from his own CSD. The CCP could also have difficulties in arriving at an equitable allocation of its settlement costs for netted transactions across multiple CSDs and participants. This is likely to lead to an averaging of costs to participants to the detriment of smaller investors.

It seems to us that CSDs cannot compete in the sense that the most efficient will drive out all other competitors. This is because the whole concept of a CSD relies on the fact that the number of securities recorded by the home CSD for any given security must always mirror the number of dematerialised securities issued by the underlying company or government. CSDs can use links to intermediate on behalf of their customers, but that must add an additional layer of cost.

We believe that although CSD links were a rational answer to the question of how to facilitate the movement of collateral around the eurozone, they do not represent a sensible or viable alternative to an integrated pan-European settlement process.

To the extent that there are core services associated with settlement, we believe that the best solution for Europe would be to migrate to a single, user owned and governed CSD. Non-core services should be open to free and fair competition that might include the single CSD or other intermediaries. To avoid cross-subsidisation, the CSD's tariffs should be unbundled so that users only pay for the services they receive. Tariffs should be sufficient to cover operational expenses, contingency and necessary systems investment. Any surpluses should be rebated to the users. The operational management should be challenged to drive for further efficiencies and risk reduction through an adequate, structured incentive scheme. Access to the system should be open, equitable and transparent. There should be a regular process to realign ownership and governance rights with usage. The domicile and contractual legal jurisdiction of the single CSD is less important than the absolute requirement that the legal foundations are sufficient to allow investors to understand the quality of title they have acquired and their position in the event of a close-out situation.

Clearly, with a single system the concept of "cross-border" settlement will cease to exist within the markets covered. This should not only assist large firms in managing their portfolios more efficiently. For the smaller investor the settlement of an "overseas" trade will be no more costly or difficult than for a "domestic" transaction. This cost neutrality should then encourage investment across borders and increase the opportunity for companies seeking capital to tap into a wider audience that in turn should make it easier to raise money for investment.

A process of migration is important, in part to allow for the realisation of value from existing investments and also to give time to prepare for integration. From the experience of the UK in bringing together the settlement of corporate securities and government debt onto a common platform, integration is a complex and time consuming process even when the systems are under common ownership and control and operating under a common legal jurisdiction.

It will be important to establish widespread acceptance of a credible migration plan. To us, the migration plan is the part of the jigsaw that has been missing. We believe that the market is best placed to devise the way forward, but could benefit from a clear statement of public sector expectation (including a realistic timeframe for delivery). Too fast and we court disaster, but not so slow that no progress is made.

It is conceivable that merger and acquisition activity between the service providers will move us towards an integrated, market owned solution. In such situations the inevitable time lag between the

legal consummation and rationalisation of platforms allows the opportunity for the system provider to introduce commonality of process (consistent with the market level reforms advocated by the Giovannini Group). However, that alone will not be sufficient to provide the integrated and efficient process we desire. Public sector intervention will be necessary to address the legal and fiscal issues identified by the Giovannini Group.

Absent that merger and acquisition activity we still support the reforms suggested by the Giovannini Group, albeit that consolidation and integration may take a little longer to effect. We do not see interoperability/harmonisation as an end state. However, as an interim process those reforms should take us to a point where the service providers "look and smell" the same, at which point the economics of consolidation should become overwhelmingly apparent, and the process of consolidation relatively straightforward.

One area that tends to be overlooked is the interaction between CSDs and payment systems. As payments are an integral part of the securities settlement process, it follows that a critical interdependence exists between payments and securities settlement systems.

In recent years there has been an increase in the number of links between payment and settlement systems (both at the domestic and international level), to facilitate cross-border settlement, delivery versus payment or payment versus payment. Those initiatives have brought benefits from opening up markets to new investors to removing settlement risk. However, when coupled to the emergence of time critical payments and securities settlements, risks arise that have thus far not been given sufficient consideration.

As central bank money is typically the settlement asset for payments between commercial banks, there is an increasing demand for cash liquidity that underpins those transfers. This results in settlement banks holding many different pots of cash liquidity around the globe to meet the peak demand in each underlying system at any given time on any given day. Fragmentation of cash liquidity is inefficient and it follows that further increases in demand will require the settlement banks to hold higher and higher levels of eligible collateral (the assets required to source central bank money, primarily government debt) purely to support and maintain efficient levels of settlement. In time this traditional approach to generating cash liquidity could distort the economics of the underlying bond markets.

Furthermore, the global network of real-time links creates a requirement for 100% operational resilience or the ability to quarantine very quickly that part of the infrastructure that might be experiencing operational difficulties. Absent such measures there is a risk that the links will spread contagion, threatening global payment gridlock. Regulators, system operators and payment banks need to consider the implications of system outage on both their domestic environment and at the global level.

The operating hours of payments and securities settlement systems need to be synchronised to allow the timely funding and defunding of settlement accounts on a straight through processing basis. The design of securities settlement systems will dictate the amount of money needed to effect settlement that in turn could adversely impact on the efficiency of payments markets and vice versa. As a matter of principle, the design of payments and securities settlement systems should ensure that both are able to operate efficiently. Large value transfers from securities settlement systems towards the end of the business day should be avoided, as these can be disruptive to the cash markets.

In a similar vein the prospect of Continuous Linked Settlement gives rise to a funding requirement that will fall within a concentrated timeframe where a cash shortage in a CLS eligible payment system could disrupt the timely settlement of foreign exchange payments in all other CLS eligible currencies. The operational schedule of securities settlement systems could compound or alleviate those cash pressures.

As links between CSDs and payment systems gives rise to cash liquidity pressures and requires 100% operational availability we would suggest that it would be easier to manage those issues if we had a single pan-European CSD. Whatever CSD structure the market adopts, it is clear though that the interaction with payment systems will need to be managed and to that end we believe that CSD and payment system operators should be represented on each other's boards and management committees.

Conclusion

- The existing clearing and settlement processes in Europe are reasonably efficient in isolation, however, from a cross-border perspective, fragmentation makes the whole unnecessarily inefficient.

- Our overriding concern is that we have safe and efficient clearing and settlement processes (capable of supporting long-term growth) to support a competitive pan-European capital market.

- Although much has been said and written about the need to rationalise and improve the process, little has actually been achieved.

- The absence of an agreed vision of the necessary infrastructural, legal, fiscal and regulatory change and, most importantly, the way to achieve that vision results in inertia, and vulnerability where those involved continue to commit scarce technical resources to support developments across multiple external systems.

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- We welcome regulatory attention in this area, as there are 3 key areas where only public sector intervention can remove barriers to consolidation:

  - Harmonisation of securities law such that a market participant can easily determine their rights with certainty. A market participant's claim on its securities and any associated benefits must be beyond challenge. That certainty should not be diminished through the use of intermediaries, e.g. custodians. The process of enforcing those rights must be clear and unambiguous. The point of settlement finality for both securities and funds must be obvious and universal.

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Glossary of terms used

Term	Definition
Central counterparty (CCP)	an entity that legally interposes itself between the parties to a transaction in a financial instrument so as to become the principal to both sides of the transaction.
Clearing	the process of computing the obligations - both to deliver securities and to pay cash - of the counterparties to a securities trade. Depending on the clearing process, such computations may be on a gross basis (trade for trade) or a net basis (offsetting of mutual obligations). In some cases, clearing may involve the novation and substitution of contractual obligations to other counterparties (see Allotment) or interposition of a central counterparty (see CCP).
Central securities depository (CSD)	an entity that performs issuance, settlement and custody of securities that are processed by book entries. A CSD administers securities accounts and provides corporate events related services. In addition, a CSD also may provide clearing services without acting as a CCP and the calculation of settlement obligations has no legal impact on the cleared contracts.
Delivery versus payment (DVP)	a settlement mechanism for the exchange of securities against payment. The object is to ensure that the final transfer of the securities occurs if, and only if, the final transfer of cash occurs, i.e. simultaneous exchange of securities and cash (i.e. neither party gives up one asset without irrevocably receiving an agreed counter-asset). Among the issues raised when considering ways to achieve DVP in the context of the often multijurisdictional, multicurrency and multi-time-zone environment of cross-border settlement transactions are such factors as the time coordination or elapsed time between asset transfers, the irrevocability of the transfers and of any interim transactions, such as of position netting, credit or collateral substitution; and the creditworthiness of the parties, agents and systemic processes.
Finality	irrevocable and unconditional settlement or transfer of securities and cash as defined by the rules of the system and enforced by laws or regulations.

Term	Definition
Natural monopoly	the situation that arises when a single firm can satisfy the entire market demand for a good or service at a total cost lower than when any collection of two or more firms divide the total among themselves. An industry can be regarded as natural monopoly if production by a single firm is the outcome of unrestricted competition.
Netting	refers to the reduction in the amount of positions, obligations or the levels of exposure of trade parties achieved by setting a participant's debits and credits off against each other leaving a smaller net obligation. Netting may take several forms that have varying degrees of legal enforceability in the event of the default of one of the parties such *multilateral netting* and *netting by novation*. Multilateral netting is an arrangement among three or more parties to net their obligations. The multilateral netting normally is conducted through a CCP. The multilateral net position is also the bilateral net position between each participant and the CCP. Netting by novation is agreements provide for individual contractual commitments to be discharged at the time of their confirmation and replaced by new obligations forming part of a single agreement.
Real Time Gross Settlement	the continuous (real-time) processing of transaction by exchanging assets (e.g. securities versus funds transfers) on an order-by-order basis with no intervening netting of either side of the transaction.
Settlement	the act of discharging the obligations of the counterparties to a securities transaction by the delivery of the securities from the seller to the buyer and the payment of cash by the buyer to the seller. However, the settlement of securities does not always involve the delivery of securities against payment. It could take the form of a delivery of securities without any funds transfer (free of payment) or a delivery of a category of securities against another (delivery versus delivery). The settlement of the cash side of a securities settlement can occur either against central bank money or against commercial bank money.