



Joint Work of the European System of Central Banks and the Committee of European Securities Regulators in the Field of Clearing and Settlement

A response to the call for contributions from the
BRITISH BANKERS ASSOCIATION

Summary

The British Bankers Association (BBA) believes that there are significant impediments to cross-border clearing and settlement. These are slowing the development of a Europe wide capital market. Market forces, inspired by the introduction of harmonised technical and market practices, should be the driver that will facilitate the greater interoperability between national CSDs (central securities depositories) and central counterparties (CCPs).

Competition is the best mechanism to bring about the necessary consolidation of the European clearing and settlement environment. Legislative and regulatory intervention should be limited to removing the legal and tax barriers that hinder cross-border clearing and settlement activity.

We support the group in its desire to examine all financial products that trade across borders and to review the full range of participants in the clearing and settlement architecture. However we believe that the group should focus in the main on the activities of CSDs, CCPs and International Central Securities Depositories (ICSDs). These are the key points of cross-border interaction.

The group has highlighted two areas in its call for contributions where we do not believe it should spend too much of its limited resource. These are *settlement cycles* and *operational risk*.

We believe that, although shorter, harmonised settlement cycles are ultimately preferable, a thorough cost/benefit analysis should be undertaken before industry wide initiatives to truncate already acceptable practices are taken forward. We remain unconvinced that the benefits would outweigh the significant costs our members would directly incur or indirectly pay for.

Operational risk mitigation practices are still developing and will be crucially influenced by the eventual outcome of the Basel Committee on Banking Supervision proposals on operational risk.

The BBA looks forward to working with the group as it develops its thoughts in the important area of cross-border clearing and settlement.

Introduction

The BBA is pleased to respond to the joint ESCB/CESR call for input into the group's planned work on clearing and settlement in the European Union (EU).

The BBA represents almost 300 international banks that are active in the UK. Eighty five per cent of members are involved in providing wholesale banking services and three quarters of the members are of non-UK origin, representing 60 different countries. The fragmented nature of European clearing and settlement is a common cause of comment from our members and we therefore support the group in its plans to promote the efficient and proper functioning of securities clearing and settlements within the EU.

We expect the demand for cross border trading to increase further as investment strategies evolve toward sector, rather than geographically based implementation, following the introduction of the Euro and the increasing realisation by European citizens that they must take responsibility for their own retirement planning.

We agree with the Giovannini group's findings that fragmentation of clearing and settlement impedes cross border trading. This results in inefficiency and higher costs to pan european investors. We support its proposals that a market led approach to the harmonisation of technical and market practices that facilitate inter-operability between national systems is most appropriate.

We believe this will allow investors to select the clearing and settlement route which best meets their needs and will, in due course, lead to a beneficial rationalisation in the number of CSDs and CCPs in the EU.

We look forward to establishing a dialogue with the group and contributing to its work in the coming months. In the following sections we have responded to the groups request for input on the issues it has raised.

Response to specific issues raised

2.1 *What should be the legal nature of the recommendations?*

We believe that the group should establish common principles and promote harmonisation of standards and market practice. It should not recommend the creation of complex regulations about access, pricing and transparency as a means to open up the market. Rather it should encourage the Commission to ensure market participants have direct remote access to CSDs by encouraging the Competition Authorities to examine any emerging anti-competitive practices promptly and fully to ensure universal access.

In our opinion the only barriers that require EU and national legislation relate to current differences in member country law about taxation, (for instance in relation to withholding tax), to the treatment of netting (to increase the certainty of multi lateral netting systems) and the promotion of the place of the relevant intermediary (PRIMA) as a solution to possible conflict of law rules.

2.2 *Addressees*

We envisage that some of the group's recommendations will be directed at regulators to ensure for instance common licensing standards for CSDs, and at legislators, to encourage the removal of any legal and tax barriers it identifies. However the majority of its recommendations should be in the form of harmonised standards aimed at systems operators and users to ensure greater inter-operability.

2.3 *Scope*

We do not think that the group's work should be limited to particular types of service provider. All entities that play a significant part in the clearing and settlement process should be reviewed, including custodians and registrars. We believe however that any standards the group may promulgate should focus on interaction between CSDs, ICSDs and CCPs. We envisage that these would then be adopted as part of the normal market process by credit institutions which provide custody and registrar services. Banks will wish to develop their own commercial solutions without undue prescription from legislators and regulators. However, the European clearing and settlement environment would benefit from a clear definition of what constitutes a CSD, CCP, registrar or custodian. Where possible these should be based on existing definitions contained in, for instance, the Finality Directive or the draft Directive on Financial Collateral. In this way common elements of the activities of different types of participant could be identified and aligned.

We recommend that all types of financial service products be included in the group's work but with a focus on cross border trading, as this is the area of greatest concern to our members. As cross border practices are aligned so domestic ones will follow.

2.4 *Objectives*

We agree with the group's perception of the objectives of central banks and regulators. In examining them we encourage it to take a holistic approach, recognising and addressing the knock on effects that recommendations in one area could have on others, not only in the area of clearing and settlement but also on cross border payments.

2.5 *Access conditions*

As a general principle we believe access to all clearing and settlement processes should be open, equitable and transparent and that users of clearing and settlement services should be free to use them in the way that best suits their needs, through intermediaries such as global custodians if they wish.

We believe the group will want to consider both the horizontal and vertical models and their impact on users' ability to make choices by understanding the true costs of each element of the services they purchase.

2.6 *Risk and weaknesses*

Difficulties with cross border settlement arise from the different legal, regulatory and historical contexts in which national CSDs have developed. We believe that, of the risks and weaknesses identified by the group, the most pertinent and susceptible to positive change

under its influence lie in the areas of legal, tax and regulatory practice. Operational risk mitigation is receiving a lot of attention in the international arena and we recommend that the group does not devote too much of its necessarily limited resource to this area, until more information about Basel's proposals is available.

2.7 Settlement cycles

Harmonised standard settlement cycles for all products would be beneficial, although the market functions adequately now without such standardisation, with many fixed income products already settling on a T+1 or T+0 basis. Whilst shorter settlement cycles are to be preferred to longer ones, we are unconvinced that that benefits of a shorter settlement would outweigh the significant costs and upheaval that that would be required to move, for instance, to T+1 settlement.

We do not believe that the Group should focus unduly on the need to shorten settlement cycles per se. A significant fly in the ointment of securities settlement generally is the need to cater for physical share certificates, be they in bearer or registered form. Moving such certificates from general circulation will be difficult without public sector action to promote dematerialisation. An outcome of the Group's work could be recommendation that further resource be devoted to achieving this.

2.8 Structural issues

To the extent that there are core services associated with settlement, we believe that in an ideal world the best long term solution for Europe would be to migrate to a single utility type, user owned and governed CSD. Its purview need not necessarily be limited to just Europe. The CSD's tariffs would be unbundled so that users only pay for the services they receive. Tariffs would 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. There should be a regular process to realign ownership and governance rights with usage.

This is a long-term and perhaps idealistic vision, which we expect to be achieved by the migration from a multitude of CSDs to one, through merger and acquisition activity. It would not be appropriate for this model to be forced upon the market through legislative action or undue coercion from the authorities. Rather the interoperability and harmonisation of standards, which the Giovannini group has recommended and which we support, should take the market to a point where all CSDs provide a similarly configured service allowing seamless interconnectivity. At this stage the economies of scale that consolidation provides would become overwhelmingly apparent. The integrated, market owned solution to which we aspire would then be created, through a last round of CSD combination. It is this vision that the group should hold in front of it as it undertakes its work. We look forward to its realisation.