

ZENTRALER KREDITAUSSCHUSS

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BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS E.V. BERLIN

Ms Daniela Russo
European Central Bank
Kaiserstrasse 29

60311 Frankfurt am Main

Mr Fabrice Demarigny
Secretary General of the CESR
17 place de la Bourse

75082 Paris Cedex 02
FRANCE

10178 Berlin, 6 May 2002
Burgstrasse 28
Qd/g - AZ: K 2

Joint work of the European System of Central Banks and the Committee of European Securities Regulators in the field of clearing and settlement

Ref.: 413-VN

Dear Ms Russo,

Dear Mr Demarigny,

The Zentraler Kreditausschuss (ZKA) is pleased to take up your call for contribution to the future joint work of the ESCB and the CESR in the field of clearing and settlement. The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, and the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks. Collectively, they represent more than 2,500 banks.

Future securities clearing and settlement arrangements, including safe custody, in Europe are of key importance for the creation of an integrated financial market and thus also of

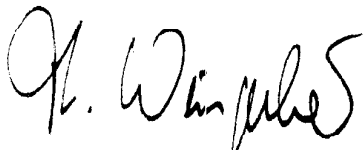
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particular interest to our member banks. Besides structural issues, our main concerns in this connection are the establishment of a level playing field for all providers of the same services and the removal of barriers or inefficiencies in the area of cross-border securities clearing and settlement.

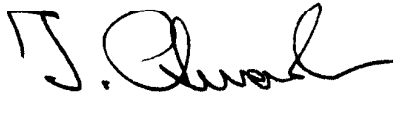
For further details, please see the enclosed comments.

Yours sincerely,

For the Zentraler Kreditausschuss
Bundesverband deutscher Banken



Thomas Weisgerber



Iris Quade

Enclosures

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Comments

**of the Zentraler Kreditausschusses¹
on the ESCB-CESR Working Group questionnaire
on clearing and settlement in Europe**

¹ The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR) for the cooperative banks, the Bundesverband deutscher Banken (BdB) for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschland (VÖB) for the public sector banks, the Deutscher Sparkassen- und Giroverband (DSGV) for the savings banks group and the Verband deutscher Hypothekendarlehenbanken for the mortgage banks. Collectively, they represent more than 2,500 banks.

We are pleased to take the opportunity, as the Zentraler Kreditausschuss (ZKA), to comment on the above questionnaire. The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, and the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks. Collectively, they represent more than 2,500 banks.

We particularly welcome the inclusion of market participants at such an early stage in the proposed project and possible regulation of the European market for clearing and settlement. In response to your questionnaire, we should like to comment as follows on the potential tasks of the Group, which is composed of representatives of the European System of Central Banks (ESCB) and the Committee of European Securities Regulators (CESR):

- **Scope**

We see no need to examine domestic securities clearing and settlement arrangements, as processes in this area have been largely optimised. This is reflected, on the one hand, in low securities clearing and settlement costs and, on the other hand, in the relatively moderate prices for system users, from which final consumers also benefit. This goes in our opinion for virtually all EU member countries. Inefficiencies do exist, however, particularly in the area of cross-border securities clearing and settlement, which we see as also including safe custody. Most of the barriers concerned have already been addressed in the Giovannini Group's report entitled "*Cross-border clearing and settlement arrangements in the European Union*". May we also draw your attention in this connection to the ZKA's comments, which we endorse as a ZKA member and enclose for your information (**Enclosure 1**). We suggest that the Group deals primarily with the inefficiencies in the area of European cross-border securities clearing and settlement.

- **Nature of the recommendations and addressee**

As far as the scope of the new Group's work and the kind of recommendations it issues are concerned, we believe that it is not possible to generalise on the legal nature and addressee of the recommendations of the Group or the European institutions. Instead, we feel that the work of the Group should be differentiated according to the type of inefficiencies investigated, like for example in the Giovannini Group's report, which made a distinction between technical/market-related, tax and legal barriers. The investigations should not focus on different groups of undertakings but should be geared instead to the various services provided, as the growing interdependence of markets means that the lines between providers of trading, clearing and settlement and

safe custody services are not always distinct. The different financial instruments should likewise be a distinguishing feature in the envisaged investigations. Only once the scope of the Group's work has been fixed and existing inefficiencies have been identified can suitable measures to remove these be specified.

- **Objectives**

We firmly support the objectives that are to be pursued by the Group in its work. However, when creating a level playing field, not only the relationship between users and system providers but also that between individual users/system providers themselves should be considered. The creation of a level playing field in which all providers can provide their services by competing freely with one another should be the main aim of any regulation.

- **Risks and weaknesses**

In this light and in response to questions 2.5 – 2.8, we see – as already mentioned above and as pointed out in our comments on the Giovannini Group's report – a need for action in the area of cross-border securities clearing and settlement. However, regulatory intervention is only needed where inefficiencies cannot be removed by market participants themselves. This is the case where there are different system access conditions for domestic and foreign users or risks due to differing legal and tax provisions at national level (e.g. withholding tax regulations in Italy and Portugal). The legal uncertainty here ranges from questions concerning transfer of title when financial instruments are purchased to safe custody of such instruments. An aspect that merits special attention in this connection is the definition of final, irrevocable transfer of title and of acquisition of title – particularly in the area of cross-border intraday settlement (currently not yet possible).

Also, in order to keep risks to a minimum, we are in favour of full clearing and settlement of securities transactions in central bank money at the CSDs covering each home market.

- **Access conditions**

We do not know of any provider of clearing services who operates different system access conditions for foreign participants than for domestic participants. There are, however, indirect obstacles to access due to different access to central bank money. For example, although foreign banks can also open a central bank account, overnight credit facilities are not available to them.

- **Settlement cycles**

The avowed long-term aim of market participants is shorter settlement cycles in order to limit market price risks through prompt delivery of securities. Shorter settlement cycles only make sense, however, if the technical/market-related conditions support

this approach and do not themselves jeopardise it because they are unable to cope with the shorter cycles.

Generally speaking, there is no need to adopt different settlement cycles for different financial instruments. Should harmonised settlement cycles be considered, they should not be allowed to put the parties concerned in a worse position. From the German standpoint, the settlement cycle should therefore be no longer than t+2.

- **Structural issues**

Although European clearing and settlement structures can definitely still be optimised, we see no need at present for any regulatory intervention in this area. The market has been undergoing a process of consolidation for some time now, so that we see no reason for the European institutions to intervene. We should also like to present in the following a market model that could serve as a basis for further discussion:

The European Equity Cross Border Operator Model

The existing inefficiencies in the marketplace are mainly due to the large number of system providers and the lack of links between these. The requirement to facilitate communication and minimise risk by establishing direct links to all systems could be met by setting up a “European Equity Cross Border Operator” as a central access point. For further details of this concept, please see the enclosed overheads (**Enclosure 2**).

While we are not explicitly in favour of setting out the results of the Group’s work in a special communication, we nevertheless strongly support pooling the initiatives of the different institutions at European level in order to create the framework that is needed in our view to allow efficient clearing and settlement of cross-border securities transactions.

Enclosures

Encl. 1

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European Commission
Internal Market DG
Financial Markets Directorate
B – 1049 Brussels

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8 March 2002
Burgstraße 28
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K 2 - Qd/To

ZKA comments on the Giovannini Group's report on "Cross-Border Clearing and Settlement Arrangements in the European Union" of November 2001

AZ: 413-VN

Dear Madam, dear Sir,

Please find enclosed, for your information, our comments on the Giovannini Group's report on cross-border clearing and settlement in the EU. Since the report has been drafted at the instructions of the European Commission and is intended to form the basis of a second, more detailed report, which will possibly contain recommendations for EU legislation, we would like to advise you of our position.

The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are: the *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken* (BVR) for the co-operative banks, the *Bundesverband deutscher Banken* (BdB) for the private commercial banks, the *Bundesverband Öffentlicher Banken Deutschlands* (VÖB) for the public-sector banks, the *Deutscher Sparkassen- und Giroverband* (DSGV) for the savings banks group and the *Verband deutscher Hypothekensbanken* for the mortgage banks. Collectively, they represent more than 2,500 banks.

We welcome the Giovannini Group's initiative and largely agree with your assessment of the existing barriers to cross-border clearing and settlement. In our view, the following

points should be borne in mind in undertaking a further review of the European market and in formulating any rules and regulations.

- Due to the large number of European and international initiatives on clearing and settlement, market participants have had to deal with a proliferation of questionnaires and consultation papers. These should be scaled back to a more reasonable number in future so that the documents may be examined and processed with the necessary care and thoroughness.
- At European level, along with the initiatives of the Commission (Competition Directorate-General, Internal Market Directorate-General), there are also endeavours by the European Central Bank in collaboration with the European securities regulators (CESR) to create a more efficient market for clearing and settlement. These activities should be merged.
- In principle, we believe it is essential to regulate clearing and settlement in the EU in order to create equal conditions for all market participants. This applies particularly to the tax-related barriers identified in the report, as well as to the barriers caused by the lack of legal certainty in the area of cross-border clearing and settlement. To eliminate the barriers caused by differences in technical requirements and market practices, regulation might only be necessary in the sense of creating a level playing field in terms of equal access for all market participants. Such initiatives should be addressed in a separate piece of legislation, not in the review of the Investment Services Directive (ISD). Otherwise, the update of the ISD would be delayed for too long.

Should you have any queries regarding our comments, please do not hesitate to contact Ms Iris Quade.

Yours sincerely,

On behalf of the Zentraler Kreditausschuss

Bundesverband deutscher Banken



Hansjörg Döll



Iris Quade

Enclosure

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BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS E.V. BERLIN

Comments

of the Zentraler Kreditausschusses
on the Giovannini Group's report on
„Cross-Border Clearing and Settlement Arrangements in the European Union“
of November 2001

Clearing and settlement systems and their importance for the smooth functioning of the financial markets are increasingly becoming the focus of national and international attention. We therefore welcome the European Commission's mandate to the Giovannini Group to examine the existing European market and identify the areas where there is room for improvement.

In this first report on cross-border clearing and settlement arrangements in the European Union, the Giovannini Group provides an overview of the current European clearing and settlement infrastructure and identifies existing barriers to a more efficient European securities market. A second report, to be published in the course of this year, will assess the prospects for the market, with a particular emphasis on public policy aspects.

1. General observations

For some time now, efforts have been underway at national, European and global level to improve the efficiency of securities clearing and settlement arrangements, given their importance for the increasingly interdependent international financial markets. Examples of such efforts are the G30, ISSA and FIBV initiatives, and particularly the work of the CPSS-IOSCO Joint Task Force on Securities Settlement Systems (SSSs), whose final report, containing 19 recommendations on SSSs, was also published in November 2001. These initiatives mean that operators of clearing and settlement systems are confronted with a host of questionnaires and consultative documents whose importance for the market in the future is often difficult to assess. The findings of the Giovannini Group are based, too, on a survey of market participants commissioned by the Commission's Directorate-General for the Internal Market; in addition, the Directorate-General for Competition also consulted the market last year on competitive aspects. Generally speaking, the large number and close timing of initiatives create the danger that not all these initiatives can be handled with the required care, meaning that the envisaged objectives are not automatically achieved.

There is also the danger of different initiatives being pursued simultaneously at European level. Besides the Commission surveys already mentioned, the European Central Bank

also announced in October last year that – like the global cooperation between the CPSS and IOSCO – it would be working together more closely with the CESR in the area of clearing and settlement systems and has since set up a working group for this purpose. The aim is to adapt the 19 CPSS-IOSCO recommendations to fit the European market. The private commercial banks in Germany are firmly in favour of concentrating these activities in order to avoid any duplication or overlapping of the same and any resulting friction in the European market.

The aim of any regulation should be to intervene only where inefficiency cannot be eliminated by market participants themselves and cost-benefit considerations appear to justify intervention. You will therefore find enclosed (Annex 1) a list of priorities for removing technical/market-related barriers. Generally speaking, the forces of competition can only work if there is a uniform regulatory framework within which market participants can operate on a level playing field, i.e. under the same access conditions. We therefore support regulation which establishes such a framework.

We are aware that at this stage the report cannot deal with all aspects of the many different market participants, trading instruments, trading practices and the like. These aspects should be taken into account in the planned second report so as to (a) rule out misunderstandings and (b) more clearly identify individual barriers with a view to removing these. The appointment of separate working groups for equities, bonds and investment funds can be seen as a step in this direction.

2. Specific remarks on market analysis and barriers

Section 3: Overview of EU clearing and settlement infrastructure

As far as the analysis of the existing market is concerned, we feel that a more specific and more comprehensive overview than those already published is required. The description of the existing links between the different systems could, in particular, give rise to misunderstandings. The overview fails to mention, for instance, that the quality of links may differ considerably, e.g. where it is a question of whether only the transfer of securities takes place or whether the payment operation is also handled and how. These

factors may also contribute to the complexity of securities clearing and settlement processes. Moreover, the existence of a link does not say anything about whether it is also actually used. May we also point out that the list of links given for Clearstream Banking Frankfurt (CBF) is incomplete.

Section 4: Cost of clearing and settling cross-border securities transactions

Assuming that Table 4.1: *Fees for Settlement in the EU* sets out the fees for internal transactions in a clearing and settlement system, we would ask you to correct the figure for Germany for equity from € 0.25 – 0.40 to € 0.125 – 0.85. In Table 4.2: *Operating income per transaction*, the number of transactions for CBF should also be corrected from 125 to 142 million and, likewise, the OPINC/transaction from € 2.15 to € 1.89. OTC transactions were not included here. Also, the method used to take account of netting when determining the operating income per transaction appears questionable, as it does not produce any figures allowing a comparison with systems without netting. We assume that these points will be accommodated in the second report scheduled for the middle of the year.

Section 5: Barriers to efficient cross-border clearing and settlement

Barrier 1 is imposed by existing differences in information technology and system interfaces. Standardisation in this area could certainly help to make the clearing and settlement of securities transactions more efficient. However, to avoid any step down from existing systems, such standardisation would have to be able to offer at least the service provided by national systems. Real improvements will, however, not be obtained until the underlying processes are harmonised. If country-specific fields, such as special taxes, still have to be taken into account, the benefits of technical standardisation are limited.

Barrier 2 focuses on the fact that transactions conducted on certain trading platforms often have to be cleared and settled through a particular system. Exchange rules and regulations in Germany stipulate that a company may be admitted to trading if, among other things, it can ensure orderly trading on the exchange. This condition is fulfilled if the applicant settles its trades through CBF and a *Landeszentralbank*. Such or similar

arrangements are contained in the rules and regulations of all German stock exchanges. As far as we know, the same goes for most of the stock exchanges in Europe, which each designate one or more organisations to ensure the clearing and settlement of trades. Such structures should not generally be seen as an impediment; in particular, the mere fact that an explicit clearing and settlement route is stipulated is not in itself evidence of existing inefficiency. Besides CBF also SEGAINTERSETTLE (Eurex Clearing) and Euroclear-Bank (Eurex Bonds) operate as clearing and settlement organisations for stock market transactions. As already explained in our general observations, a market participant may reach a different conclusion if, in order to settle a securities transaction, he is required to transfer securities to a different depository. Inefficiency occurs when exchanges stipulate settlement routes other than via the local depository. In trading via Euro-MTS, a German bank, for example, must transfer German federal bonds, which are usually deposited with CBF, to a depository which works together with Euro-MTS, as CBF and Euro-MTS are not linked. The same goes for virt-X (trading platform for European blue chips, formed out of the merge of Schweizer Börse and Trade Point) and Broker Tec (trading platform for European government bonds). We are, in principle, in favour of the possibility to use alternative clearing and settlement systems as well via links, although this should not lead to an obligation to establish such links where this does not make economic sense.

The absence of intra-day settlement finality for cross-border securities transactions is identified as *Barrier 4*. In Germany, intra-day settlement in the form of same-day settlement, plus real-time settlement, are the standard national arrangements. Similar arrangements could remove inefficiency in cross-border transactions and should thus be pursued. It would be helpful in this connection if the term “*finality*” could be defined more precisely.

The different right of system access for national and international users identified as *Barrier 5* is a major source of inefficiency in cross-border clearing and settlement of securities transactions. In Germany, there is no such differentiation, which means there is no such barrier. Discriminatory treatment may, however, be due not only to private system operator rules but also to legal aspects addressed by national legislators or simply to

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requirements for access to central bank money accounts. The removal of these system- or country-specific obstacles should be a priority of any market regulation.

The different settlement periods identified as *Barrier 6* may be a source of inefficiency. No harmonisation should take place, however, unless this means progress for all parties involved. With risk minimisation and current trends towards T+1 in mind, the aim should thus be no more than T+2. At the same time, an arrangement geared to international foreign exchange market practice (spot currently T+2) should be also taken into account.

Harmonisation of the different operating hours identified as *Barrier 7* could, in conjunction with the removal of Barriers 4 and 6, improve efficiency. Operating hours are also often at odds with the periods for money settlement. In view of the fact that virtually all counterparties in Central Europe operate in the same time zone, settlements may be hampered by the absence of synchronised work processes although there is no real need for such a situation. Besides operating hours, bank holidays should also be harmonised, with the already defined TARGET holidays possibly serving as a basis.

As regards *Barrier 8*, differences in securities issuance practice, we wish to point out that it is less a question of purely national differences than of market-specific differences, i.e. differences relating to the issuance of equities, bonds or derivatives. Harmonisation of primary market practice would undoubtedly facilitate cross-border processes. In this connection, the intention behind identifying impediments must be clarified. It should thus be made clear whether the ideas expressed by the Giovannini Group mainly concern inefficiency from the retail customer standpoint or whether other approaches are also being pursued.

Barrier 9 concerns existing restrictions on the custody of securities and any restrictions on the registration of securities. However, these are often established structures that need not necessarily be detrimental from the angle of efficiency. For one thing, a system may provide special expertise on a particular market; for another, in addition to market

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conventions, legal aspects, e.g. concerning the dematerialisation of securities, may also play a role. Despite this, we support harmonisation in this area as well.

The national restrictions on the activity of primary dealers and market makers identified as *Barrier 10* are not specific to cross-border clearing and settlement of securities transactions but a feature of the market affecting all transactions. Irrespective of this, we support the removal of these restrictions.

We regard the removal of the listed tax-related barriers (Barriers 11-12) and legal barriers (Barriers 13-15) as the primary aim of any regulation. It is only by creating the appropriate public policy framework that market forces and the forces of free competition can bring about an efficient allocation of resources and the listed technical/market-related shortcomings (Barriers 1-10) can be removed where necessary. We therefore support the Giovannini Group's categorisation, according to which Barriers 1-10 can, in principle, be removed by market participants themselves. The only exceptions are the points where, due partly to interdependence on legal frameworks, domestic and foreign market participants are not treated equally. In the interests of a level playing field, we believe that regulatory intervention is necessary in this area as well.

Prioritisation for removing technical/market-related barriers

Priority	Barrier	
1.	Barrier 1	National differences in information technology and interfaces
2.	Barrier 2	National clearing and settlement restrictions that require the use of multiple systems
3.	Barrier 3	Differences in national rules relating to corporate actions, beneficial ownership and custody
4.	Barrier 4	Absence of intra-day settlement finality
5.	Barrier 5	Practical impediments to remote access to national clearing and settlement systems
6.	Barrier 9	National restrictions on the location of securities
7.	Barrier 6	National differences in settlement periods
8.	Barrier 7	National differences in operating hours/settlement deadlines
9.	Barrier 8	National differences in securities issuance practice
10.	Barrier 10	National restrictions on the activity of primary dealers and market makers