

Clearing and Settlement in the European Union - The way forward

Analysis of the responses to the
consultation

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Plan of the Presentation

- The Communication:
 - the objectives of the Communication
 - the actions to be taken forward
- The consultation process
- The comments received

The Commission objectives: 1

- Efficiency:
 - Cost-reduction
- Safety
- Level playing field

The Commission objectives: 2

- **Liberalisation and integration** (ensuring comprehensive access rights and removal of existing barriers)
- **Application of competition policy**
- **common regulatory and supervisory** framework (including the question of definitions)
- Appropriate **governance arrangements** to supplement the previous measures and policies

Liberalisation and integration

- Integration means a situation where all obstacles to the use of the different cross-border channels are eliminated:
 - Reduced costs
 - Greater competition
- Price reductions

The Commission actions

- **Setting** up a Clearing and Settlement Advisory and Monitoring Expert Group
- **Propose** a framework (Lamfalussy) Directive to secure a legal framework throughout the EU
- **Setting** up expert groups to address legal and tax issues
- Ensure effective **implementation of competition law**

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Consultation process/1

- 81 responses:
 - Country authorities: 4
 - Governments: 7
 - Central banks: 5
 - Securities regulators: 3
 - Silos: 4
 - CSDs: 4
 - CCPs: 2
 - Exchanges: 6

Consultation process/2

– Issuers:	3
– Banks:	26
– Investment firms:	3
– Inv. Man. Companies:	4
– Other associations:	4
– Law firms/institutes:	3
– Matching serv. Prov's:	1
– Other serv. Prov's:	1
– Private:	1

Consultation process/3

- Most respondents so far have agreed to the publication on Commission web site:
 - YES: **63**
 - NO: **2**
- For the remaining **16** rappels have already been sent and will be sent once again
- After that they will be considered as NO

Plan of the Presentation

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Comments received

- General context
- The Directive
- Access rights
- Functional approach / definitions
- Common regulatory and supervisory framework
- Supervisory cooperation
- Governance
- Expert Groups

General context

- Overall the Communication was well received
- Respondents agreed with the overarching objectives
- Most respondents agreed with the proposed multi-pronged approach
- Some respondents complained that cost reduction in cross-border C&S seems not to be the primary aim of the Commission

Cost reduction

- The Commission does not share the view of some market participants that cost reduction is no longer its primary objective, on the following grounds
 - Cost-reduction is part of the efficiency objective
 - Commission endorsed the overall approach taken in the Giovannini reports that:
 - dismantling of the identified barriers is crucial for cost-reduction and

Cost reduction

should be achieved by combined public-private sector efforts

- Commission established the CESAME group even before the end of the consultation process to achieve progress with the barriers for which action by the private sector is deemed appropriate
- Commission envisaged in the Communication the establishment of two expert groups to tackle legal and fiscal (procedural) issues

Directive

- Most respondents agreed with the general idea of a Directive on clearing and settlement, subject to the following conditions:
 - It is a Framework Directive dealing only with high-level principles
 - It is tested against a cost-benefit analysis or regulatory impact assessment

Directive

- However, respondents' opinions greatly differ as to the possible contents of such a Directive
- Nonetheless, they agree that such a Directive should have the following general contents
 - Access rights
 - A common regulatory and supervisory framework

Directive

- A couple of respondents even in favour with the Dir consider the legal/fiscal issues far more important
- A couple of respondents agree with a Directive exclusively providing for a common regulatory and supervisory framework
- A few (5) respondents disagree with the Directive

Directive

- Very few respondents favoured the idea of an EU DTCC (unified system for C&S)
- Some suggested studying the US example would be interesting with respect to:
 - Mandatory central bank money
 - A risk-free CSD model
- Others agreed in principle on the utility of this study but warned the Commission that this should not distract too many resources

Scope

- A few respondents suggested that the Directive should not cover:
 - Confirmation/matching
 - What about if these services are not provided bilaterally and are instead centralised?
 - Collateral management and asset servicing (when provided by banks)
 - The issue will not be clear until precise definitions are developed and will depend on other measures (e.g. accounting separation)

Scope

- C&S of Unit Funds
- A few other suggested that the Directive should distinguish between:
 - Equities, and
 - Debt securities
- Others suggested the Dir should cover both domestic and cross-border activity

Access rights

- Rights of access vs Rights of choice:
 - A consistent number of respondents challenged the concept of granting a right of choice to investors as this would imply that a bank would have to provide several C&S routes
- It is undisputed that conditions for access should be:
 - Non-discriminatory
 - Transparent

Access rights

On top of this, opinions differ - Respondents argued that:

- Refusal of access for commercial reasons should be allowed
- Refusal of access should be allowed only if risk-based
- Refusal of access on the basis of dimension should not be allowed
- Access requirements should be harmonised, possibly as a level 2 measures

Functional approach - Communication

- In the Communication we argued for the use of a **risk-based functional approach**
 - the same activities are subject to the same regulatory treatment, provided the risk is the same
- Two steps:
 - Definition of activities
 - Analysis of risk

Functional approach - Communication

- Intermediary – Infrastructure dichotomy:
 - As a proxy for the different risk implications
 - To deal with **governance** requirements only applying to Infrastructures
 - To deal with the provisions regarding **access**:
 - Intermediaries and Infrastructures have rights
 - Only Infrastructures have obligations

Functional approach

- In theory, many respondents agree on the functional approach - In practice, interpretations vary dramatically:
- Pure functional approach:
 - No risk considerations
 - Same activity, same regulation
- Risk-based approach (different versions):

Definitions

- A lot of reservations on the definitions suggested by the Commission, but no single set of definitions dominates
- Need to distinguish between CCP activities and other C&S activities
- Work on definitions should start in the next few weeks with your cooperation

Common regulatory and supervisory framework

Very different opinions

- The Communication underestimate the **oversight responsibilities** of central banks
- CSDs should not incur **financial risk** or, if they do, they **legally separate** the entity incurring financial risk
- CSDs should be allowed to become **banks** and therefore be subject to **Basel II**

Common regulatory and supervisory framework

- The concept of **limited purpose banks** should be considered
- CSDs, whether or not licensed as banks, should be subject to **stricter requirements** than those applicable to banks
- Custodian banks should not be subject to C&S Directive requirements

Common regulatory and supervisory framework

- Consider whether risks borne by banks are already covered under the existing banking Directive
- **C&S requirements** should apply to C&S activities, **banking requirements** should apply to credit extension (functional approach)
- CSDs should be obliged to settle in **central bank money**

Common regulatory and supervisory framework

- CSDs should give the option to settle in central or commercial bank money
- Central counterparties should be licensed as banks
- Some respondents support the idea of establishing a full set of **capital requirements**

Supervisory cooperation

- The Communication suggested the adoption of the **home country principle** but also the need to take into account the specificities of Clearing and Settlement Systems
- Market participants by and large (see below) agreed with the home country principle

Supervisory cooperation

- Public authorities, with one exception, recognised the need for greater cooperation but substantially disagreed with the home country principle
- Some market participants proposed the adoption of a model based on the concept of **lead regulator**
- The Commission will take stock of all suggestions as to how to address the specificities of C&S - will analyse the pros and cons of all options before taking a decision, without fear of being “creative”

Governance (Accounting Separation – Unbundling)

- By and large as expected:
 - Banks mostly agree
 - CSDs, CCPs and Silos disagree
 - Independent exchanges mostly agree
 - Governments are split while a few securities regulators are in favour

Governance (Accounting Separation – Unbundling)

Issues raised:

- Why do they apply to SSSs/CCPs and not to exchanges, payment systems and foreign exchange service providers?
- The idea of SSSs/CCPs having a dominant position is not theoretically founded:
 - The Commission fails to recognise / underestimates the role agent banks have in internalising settlement

Governance (Accounting Separation – Unbundling)

- The provisions on the *Societas Europea* allow competition for the issuers accounts
- The distinction between “core” and “value-added” services is misguided, inappropriate
- These measures require tremendous IT investments
- They are intrusive in the internal organisation of companies

Governance (Accounting Separation – Unbundling)

- They seem to prejudge the issue – where is the evidence of the abuse?
- They suggest a lack of faith in the effectiveness of competition policy – competition policy is sufficient
- If anything, they should apply to all C&S service providers (functional approach)
- Of course, some say the envisaged requirements are not sufficient

Governance (Accounting Separation – Unbundling)

- The available information as to the degree of settlement internalisation by agent banks is contradictory
- It would be useful to clarify this issue by carrying out with your cooperation a study on:
 - the degree of concentration in the agent banks' market and
 - the degree of settlement internalisation by the agent banks

Corporate Governance

- The picture is not very clear-cut
- Banks mostly agree, in particular a few suggest to adopt the proposed measures even before the adoption of the Directive as best practices
- Other respondents disagree, make specific proposal or express reservations on particular issues:
 - In many cases, it is suggested that the Commission action plan on corporate governance is sufficient – no need of additional measures

Corporate Governance

- The proposed measures could become part of level 2 measures
- The example of regulated markets in the MiFID could be followed
- Specific problems relate to:
 - The role of the audit / independent committee
 - The definition of independence for user-owned companies and their number in the relevant committee
 - The group structure

Expert Groups

- Unanimous support for CESAME and the legal expert group
- Close to unanimity for the tax expert group: strong opposition from UK and IRL
- Respondents emphasised the importance of tackling the legal and fiscal barriers - some arguing that most of the extra costs of cross-border C&S come from legal and fiscal (plus regulatory) barriers
- Some issues were mentioned as priority

Expert Groups

- Legal issues:
 - Appropriate framework for the treatment of interest in securities
 - Direct holding systems should be properly considered
 - harmonisation of how national laws treat investors' rights (whatever their 'nature') in case of insolvency or in conflict with other right
 - Securities location
 - Collateral issues for CCPs
 - Registration location

Expert Groups

- Tax Issues
 - Harmonisation of tax collection and reclamation processing
 - Withholding tax issues
 - Stamp duty

Discussion

- Let us open the floor on the following issues:
 - Access rights
 - Functional approach
 - Supervisory cooperation
 - Governance