

# European Commission: Report on Definitions

CESAME Group  
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# Background

- CESAME Group will to assist the Commission in developing functional definitions
- Sub-group on definitions
- Three meetings

# Background

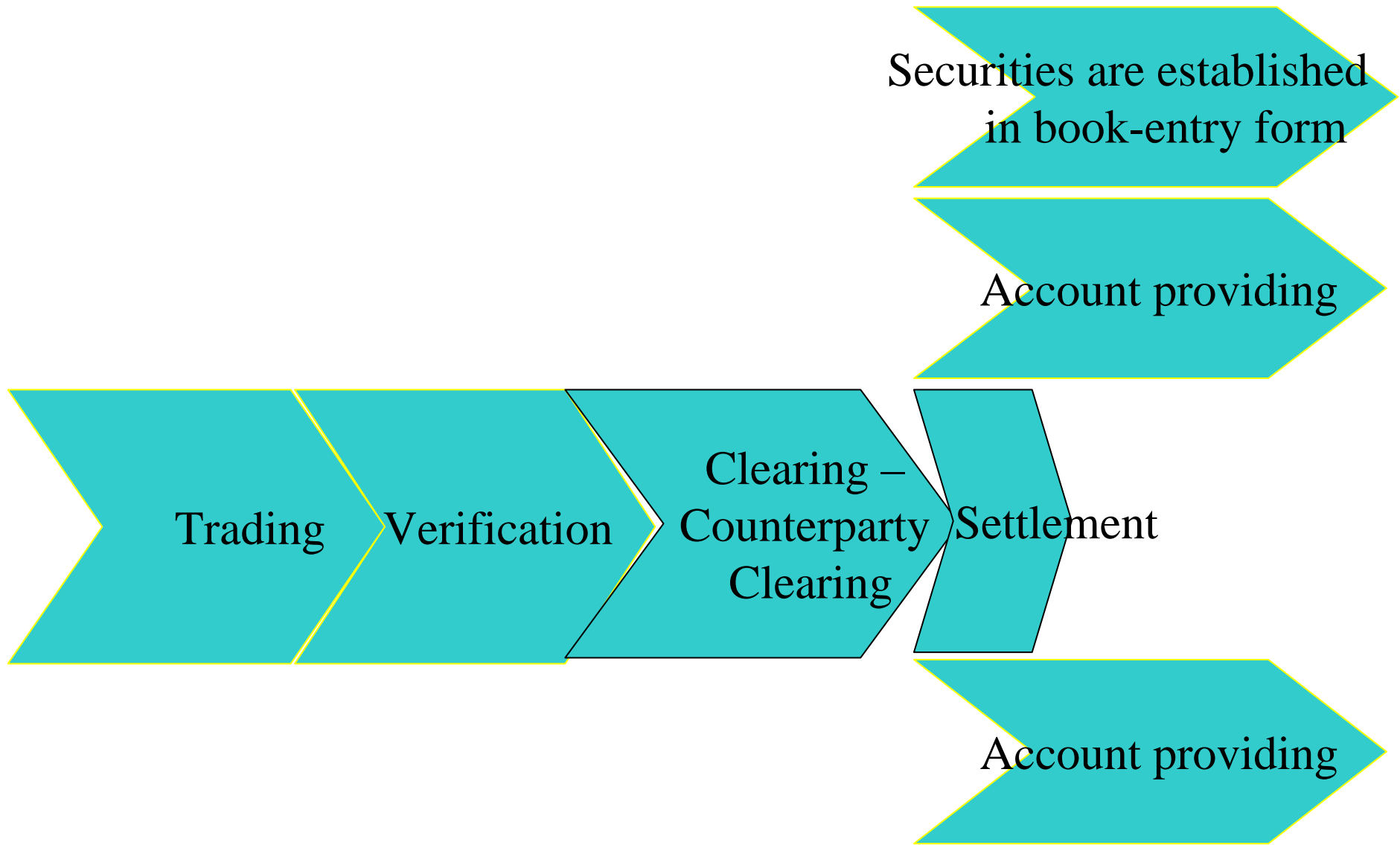
- Constraints:
  - Need to achieve some consensus
  - No “embedded law”
- Objective: a limited set of definitions, as broad and functional as possible

# Background

- No implied use for any future legal act
- Focus on securities
  - Need to adapt to derivatives

# Post-trading activities

- No consensus on the use of the term Clearing and Settlement to define the entirety of the subject-matter
- Post-trading activities
  - Flow or transaction-related activities
  - Stock or transaction-unrelated activities



# Flow-related activities

- Verification
- Clearing (very broad)
- Counterparty clearing (interposition)
- Central Counterparty clearing  
(interposition)
- Settlement (very strict: the last element of  
the process)

# Stock-related activities

- Establishing securities in book-entry form
- Issue accounts
- Securities accounts
- Deposit (physical securities)
- Account providing (CSDs and custodians)
- Asset servicing

# Verification

- *The process of*
  - *comparison and reconciliation*
  - *of transaction or settlement details,*
  - *to ensure that there is agreement on these details*

# Verification

- General definition to cover (does not mention subjects):
  - Affirmation
  - Confirmation
  - Matching
- Also covers functions performed by VMUs

# Clearing

- *The process of*
  - *establishing settlement positions, possibly including the calculation of net positions,*
  - *and the process of checking that securities, cash or both are available*

# Clearing

- Intended to cover every function performed in the course of the post-trading process between “verification” and “settlement”, except
  - Central counterparty clearing

# Clearing

- The proposed definition is very broad
- Includes
  - the resource check
  - All the procedures intended to maximise settlement efficiency

# Settlement

- *The **act** of crediting and debiting the transferee's and transferor's accounts respectively,*
- *with the **aim** of completing a transaction in securities*

# Settlement

- The proposed definition is institutionally neutral: applies both to CSDs and custodians
- Applies both to cases in which
  - settlement is internalised and
  - settlement is not internalised

# Settlement

- Pure functional definition:
  - No risk or competition analysis has been conducted, therefore
  - No implications have to be drawn in terms of risk and competitive issues

# CPSS-IOSCO definition of CCP

- *An entity that*
  - *interposes itself between the counterparties to trades,*
  - *acting as the buyer to every seller and the seller to every buyer*

# CPSS-IOSCO definition of CCP

- Two elements:
  - Interposition
  - It happens for every trade
- Interposition does not exclusively apply to CCPs

# The actors

- CM = Clearing Member
  - ICM = Individual CM
  - GCM = General CM
- NCM = Non-CM
  - A broker-dealer member of an exchange who uses the services of a GCM

# Interposition by the CCP: an example

- $A = \text{NCM}(\text{GCM1})_1 \rightarrow \text{GCM1} \rightarrow \text{CCP} \rightarrow \text{CM2} = B$
- (For a securities transaction this looks at the *obligation to deliver the securities*)
- A trade between “A” and “B” is converted into the following relations:

# Interposition by the CCP: an example

- $A = \text{NCM}(\text{GCM1})1 \rightarrow \text{GCM1} \rightarrow \text{CCP}$ 
  - GCM1 interposes between “A” and the CCP
- $\text{GCM1} \rightarrow \text{CCP} \rightarrow \text{CM2} = B$ 
  - CCP interposes between GCM1 and “B”

# Central Counterparty Clearing

- *The process by which a third party interposes itself, directly or indirectly, between the transaction counterparties in order to assume their rights and obligations, acting as the direct or indirect buyer to every seller and the direct or indirect seller to every buyer*

# Central Counterparty Clearing

- *direct or indirect interposition between transaction counterparties*
  - The CCP does not necessarily interpose directly between transaction counterparties
- *in order to assume their rights and obligations,*
  - New part meant to make explicit the consequences of the interposition

# Central Counterparty Clearing

- *direct or indirect buyer to every seller and the direct or indirect seller to every buyer*
  - gives operational contents to the term “central”

# Counterparty Clearing

- *The process by which a third party interposes itself, directly or indirectly, between the transaction counterparties in order to assume their rights and obligations*
  - Symmetric to the previous definition:
    - The last sentence is missing as there is no centrality

# Establishing Securities in Book-Entry Form

- *The initial representation and subsequent maintenance of securities in book-entry form through initial credits and subsequent credits or debits to securities accounts, on the basis of: (a) the information provided by the issuer or its agent; or (b) the number of securities on deposit*

# Establishing Securities in Book-Entry Form

- Applies to:
  - Dematerialised securities
  - Immobilised securities
- Essence: making securities become available in book-entry form

# Establishing Securities in Book-Entry Form

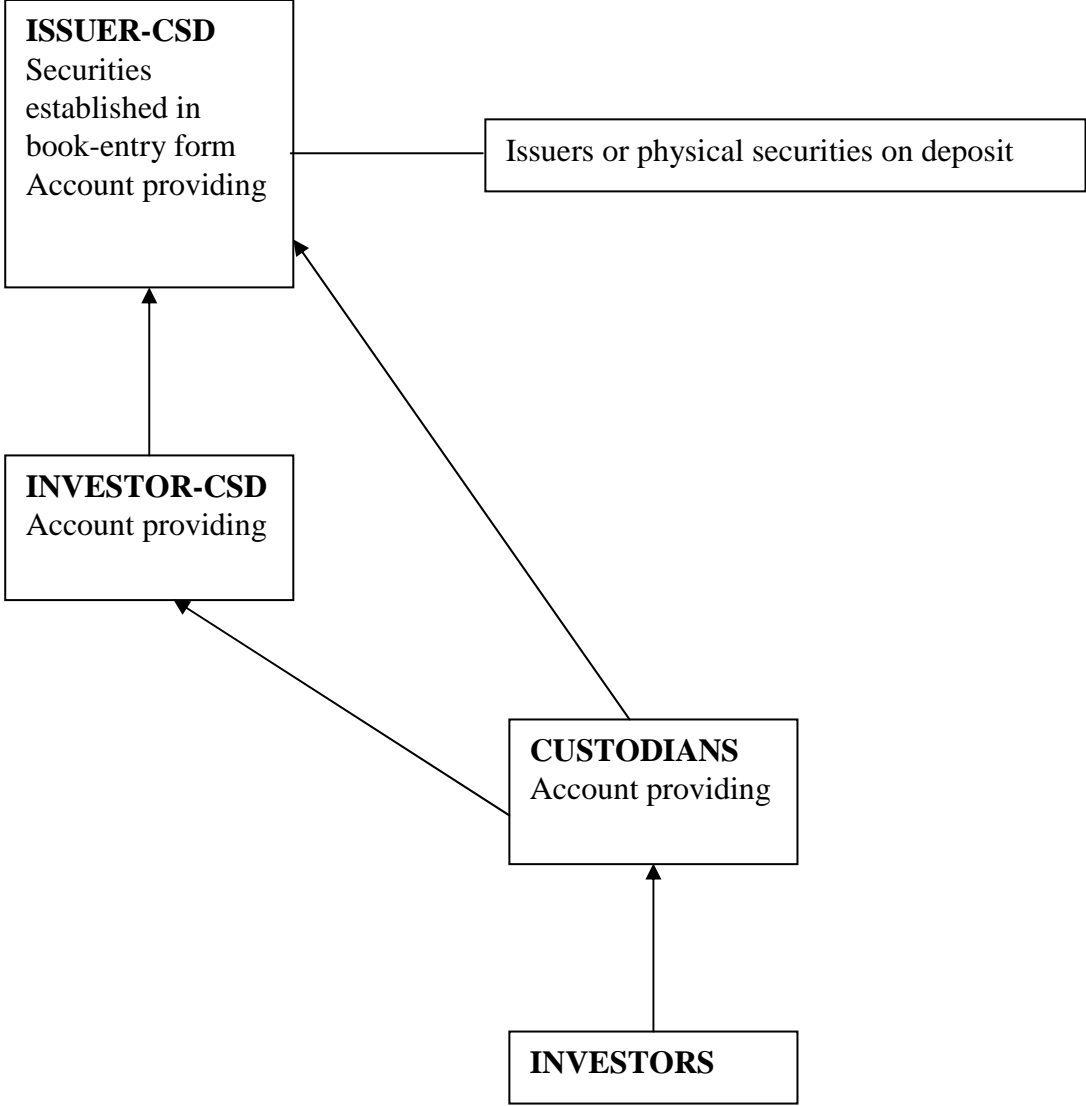
- Initial representation
  - Issuance in a CSD (typically)
- Subsequent maintenance
  - Capital increases/decreases
- On the basis of:
  - Information provided by the issuer
  - Securities on deposit

# Deposit

- *The storage of physical securities on behalf of others*
- Applies only to physical securities

# Account providing

- *The maintenance of securities accounts*
- Applies both to CSDs and custodians
- Involves a relationship between a service provider – the “account provider” – and its client – the “account holder” that allows final investors or other account holders to hold securities established in book-entry form



# Asset servicing

- *Securities administration activities performed for others, e.g. processing of corporate actions, tax reclaims and portfolio valuation*

# The future

- Need to adapt the proposed definitions to derivatives
- Plus, the Commission will ask the assistance of the Sub-Group when and if need arises