

ESCB-CESR Standards for Securities Clearing and Settlement Systems in the European Union

Submission by Thomas Murray

We refer to the above document and would comment as follows:

The concept of Standards is admirable.

Paragraph 4 The objectives of the standards

We would contend that **Objective 6 To foster the protection of investors, and in particular, retail investors** is not met by the Standards on the grounds that they do not include all the capital market infrastructure risks to which investors or asset owners are exposed to when investing in local capital markets. Banks typically do not intermediate these risks they are suffered by the asset owners e.g. the investment funds and pension funds. The Standards are essentially directed at wholesale market participants. There is a real risk that the Standards will establish a weaker asset safety environment for investors than exists today.

We would recommend that you either remove this objective or expand and specify the risks to which asset owners are exposed. If you choose to expand and define the risks which the Standards are seeking to minimise then additional checks and balances need to be embedded into the Standards (refer to Standard 17 -Transparency below) to ensure that market participants can track and analyse these risks based on complete, accurate and timely data supplied by the CSDs, CCP's and other suppliers which might be covered by the Standards. These risks are tracked on a daily basis today by agencies such as Thomas Murray on behalf of banks and investors with invested assets exceeding €15 trillion today. The capital market infrastructure risk exposures to which we refer can be grouped as follows:

- Clearing and settlement** - asset commitment, liquidity, counterparty risk exposures
- Safekeeping** - financial, operational and CSD on CSD risk exposures
- Asset servicing** - asset servicing risk exposures.

These seven risks have being fully defined together with the underlying criteria by major financial institutions. The risk categories are referred to in major studies such as the Risks and Regulation in European Asset Management published by the European Asset Management Association.(January 2001). The analysis is generated daily and used by multiple institutional funds and banks globally to enable them to track their or their clients ongoing risk exposures to capital market infrastructure risks, market by market, across the world on a comparable basis.

Ensuring that the proposed Standards, which may be adopted globally if the history of CPSS/IOSCO is repeated, support the asset safety and risk minimisation of investors assets must be a prerequisite. As currently worded we have serious misgivings about the proposed changes to Standard17 Transparency, particularly in respect of abandoning the current CPSS/IOSCO Disclosure Framework , which enables market participants to make their own risk assessments, in favour of the concept of answers

being disclosed to key questions posed by the ESCB-CESR under a new assessment methodology. These risks are significant and need daily tracking, particularly where capital market infrastructure risks are high as is the case in over 60% of all operational CSDs globally.

Standard 17 Transparency - Key elements

Much reliance will be placed by users including banks, investors and other market participants on this standard to ensure that adequate information is disclosed to enable proper risk assessments to be carried out. The issue is therefore how will ESCB-CESR ensure that sufficient information is made available to satisfy market participants, asset owners and other users? Will this information be issued on a daily basis? What assurances can meaningfully be given as the completeness, accuracy and timeliness of the information? Will there be a mechanism for third party validation of the data? Brokers and banks choosing different settlement markets and different settlement agents must know which alternative route will minimise the risk exposures for their clients i.e. the asset owners.

Key element 5 the change from a CPSS/IOSCO Disclosure Framework to an ESCB-CESR assessment methodology is particularly dangerous for investors and users i.e. the groups directly exposed to the capital market infrastructure risks within a given market. The concept of information being replaced by answers to an assessment methodology would necessitate the assessment methodology being fully developed and agreed to by all users, investors and their appointed analysts. Full consultation to agree the scope and depth of information to meet the needs of asset owners ultimately responsible for and exposed to capital market infrastructure risks would be essential before any change should be made. The existing CPSS/IOSCO Disclosure Framework enables users to analyse the risks which they have defined as being relevant to assessing CSDs.

Paragraph 184 - Balance sheets do not generally provide any comfort to investors/analysts assessing the financial risk exposure asset owners /market participants have to in CSDs. Far greater reliance is placed on, for example, guarantee funds, loss sharing arrangements, the ability to raise additional funds and raise prices to replace depleted reserves.

Paragraph 185 - The risks referred to in this paragraph and throughout the Standards document are not defined or even explicitly stated. This is an exact science and it is essential to be specific. We would contend that the risks exposures include the following;

Clearing and settlement - asset commitment, liquidity, counterparty risk exposures

Safekeeping - financial, operational and CSD on CSD risk exposures

Asset servicing - asset servicing risk exposures.

Other risks do exist but these are the primary risks to which asset owners are exposed to when their assets and transactions are held by, or routed through, these supplier types. It is essential to adopt a comprehensive range of risks and define the risks. The above risks have been in common use for over three years and every operational CSD

in the world is currently assessed on this basis and is under daily surveillance against the above risk categories.

Paragraph 186 - We would contend that there is inherent risk in key questions being posed in place of the CPSS/IOSCO Disclosure Framework on the grounds that the answers to the questions would be provided by the entities being analysed i.e. the analysis would be carried out by the entities on whom the market participants and investors and other users want reliable and independent risk analysis. This is really a case of the student marking his own examination papers and would not satisfy normal standards of independent assessment used by auditors.

We would contend that the CPSS/IOSCO Disclosure Framework should be maintained to enable market participants and users to carry out their own risk and cost assessments. What might be sufficient for the ESCB-CESR might not be adequate or timely enough for the majority of investors which suffer ongoing and continuous risks exposures to these entities.

Paragraph 187 - users need **daily** risk assessments on capital market infrastructure risk exposures including those suffered when using CSDs, CCP's or other suppliers. Annual updated of information or answers will be insufficient. Complete, accurate and timely information disclosure is essential. This information needs to be validated. We would argue that the concept of an annual update does not reflect the reality of what is going on on the ground today. Last year over 1,500 individual market or entity specific changes took place which materially affected the risk exposures of CSDs around the world. These were identified and published on the 147 operational CSDs. The answer lies not in an ESCB-CESR assessment methodology but in requiring the entities covered by the Standards to maintain their CPSS/IOSCO Disclosure Framework in a complete, accurate and timely manner for all material changes.

A running obligation should be placed on the suppliers to whom the Standard 17 applies to issue complete, accurate and timely information. The sufficiency of the information is key.

We remain willing to assist the ESCB-CESR in the further development of these Standards. We feel that the concept is valuable and as a company support the idea of Standard setting.

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