



Securities Industry Association

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December 10, 2003

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Re: Request for Comment on Consultative Report – Standards for
Securities Clearing and Settlement Systems in the European Union

Dear Gentlemen:

The Securities Industry Association ("SIA")¹, through its Cross-Border Subcommittee², is pleased to offer this letter and thereby express our support for the goals of European System of Central Banks ("ESCB") and Committee of European Securities Regulators ("CESR") in their consultative ESCB-CESR Standards Report.

We welcome this timely initiative, recognizing the complex challenges that the expansion of securities markets confers, alongside the enormous benefits. The global risks and challenges identified in the report, for the most part, are real and worthy of the continuing attention of regulators, supervisors and overseers of the world's securities markets. We commend and share the ESCB and CESR's goal of enhancing the safety, soundness and efficiency of clearing and settlement in domestic and international securities markets, and welcome your wide consultation with the industry.

¹ The Securities Industry Association brings together the shared interests of more than 600 securities firms to meet common goals. SIA member firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and international markets and in all phases of corporate and public finance. Further information about the SIA membership, committees and initiatives are available on its website, www.sia.com.

² The Cross-Border Subcommittee is comprised of a subsection of representatives from SIA's Operations Committee. The Cross-Border Subcommittee is primarily a U.S.-based group of global and regional securities firms and banks. Several of our members join us regularly from Europe, in person or by conference call, and we also have U.S.-based representatives of non-U.S. entities. Our perspective, therefore, tends to be on the growth of global cross-border securities transactions.

In this regard, we are also taking the opportunity to voice certain concerns toward the goal of urging greater global consistency and dialogue, distinguishing operational risk from credit risk and the role of intermediaries from infrastructure organizations, and highlighting the desirability of encouraging pragmatic, international technical standards for securities processing and focusing as well on enhancing the industry's standard practices for securities-related payments, including foreign exchange.

Global consistency

To a great extent, the issues raised in the Standards Report resonate with all who are involved in transacting and supporting securities business across any frontier, whether between national jurisdictions within Europe, or between Europe and other regions of the world. From our own experience of the increasingly inter-continental, cross-border nature of the securities industry, we see consistency as the key that provides the predictability on which international capital markets can grow and thrive.

The Standards Report characterizes itself as endorsing and focusing on, in a European context, the implications of the CPSS-IOSCO recommendations and other global industry initiatives, such as the Group of Thirty's ("G-30") recent work on Global Clearing and Settlement. Yet, the ESCB-CESR paper, in its emphasis on collateralization as a risk management tool, and in redefining the concept of systemically important organizations beyond operational risk considerations, seems to transcend these other initiatives.

While we understand that the intent of the Standards Report was to examine how best to integrate global recommendations into local regulations and practices, our support for the proposed ESCB-CESR standards is tempered by some dismay at the tendency toward specifically regional approaches highlighted in the draft standards. Globalization means that each new approach has potential effects far beyond any single country or region. Certainly, an economic region as important as the European Union ("EU") magnifies those effects. Regional decisions can cause fragmentation, impact global markets, and affect participation in the EU market by global and cross-border firms such as ours. That is why we feel it is important for us to offer our views.

ESCB and CESR seem to be consciously choosing to give greater priority to European cross-border issues at the expense of truly global considerations. Indeed, such extensive rewriting of the original CPSS-IOSCO recommendations seems to pit the proposed standards against the global industry's need for "transparent, consistent and effective regulation, supervision and oversight" as endorsed by Standard 18 of the Standards Report (para. 188, p. 75). We would therefore caution that such a regional approach, rather than reinforce the CPSS-IOSCO recommendations in a European context, may detract from them, at a time when many national regulators are calling within their jurisdictions for self-assessment of their infrastructure organizations against those internationally devised recommendations. Similarly, the G30 Global Monitoring Committee has begun tracking global, cross-border progress on its 20 recommendations. We therefore hope our comments can lend ESCB and CESR the additional cross-border perspective from the United States ("U.S.") to the EU, to complement the Standards Report's intra-European focus and set the framework for an even broader global dialogue.

The proposed standards themselves give encouraging priority to consistency of legal/regulatory frameworks and market practice, but a number of requirements have the potential for broad impact well beyond EU Member States. These include, for example: rules of system operators harmonized to "minimize the discrepancies stemming from different national rules and legal frameworks" (Standard 1, para. 35, p. 18); encouragement of shorter settlement cycles within the EU, albeit potentially supporting a T+0 that would be difficult to achieve universally (Standard 3, para. 46, 48-49, pp. 24-25); relationship of national bankruptcy law to segregation and protection of customer securities (Standard 12, para. 139, p. 61); and mandatory technical standards to support interoperability (Standard 15, para. 167-168, p. 69).

Beyond this, the Standards Report acknowledges that, even in Europe, implementation depends on action by individual national authorities that may impose "additional stricter obligations" (p. 4). The country-by-country approach can potentially lead to even less uniformity than we have today, undermining the predictability and legal certainty essential to international capital markets.

Dialogue beyond the EU

Underlying our comments on these EU-focused standards is the reservation that investors and their service providers outside EU Member States, going forward, would have no clear means to voice their concerns as the standards evolve into new national rules in individual European countries. We ask for the opportunity for non-EU market participants to be more actively involved by the ESCB-CESR Working Group during the finalization phase of the standards.

Should the ESCB-CESR Group want to further consider the relevance of these concerns and other U.S. securities industry experiences, in line with the European Parliamentary report of January 2003 calling for comparative consideration of the U.S. model, the SIA would be pleased to open such a continuing dialogue, toward fostering wider global understanding and potential harmonization.

Separation of operational risk from credit risk

Based on our understanding of our own regulators' focus on business continuity, we question some of the parallels drawn in certain of the references to the findings of U.S. regulators in their Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System. Similar to the SIA task force and other initiatives in preparation for Y2K, the interagency paper from our Federal Reserve, Comptroller of the Currency, and Securities and Exchange Commission prioritizes operational risk management aspects of business continuity and recovery. These initiatives were never aimed at credit risk management. In this context, we do not consider it productive to link operational risk issues for core infrastructure organizations with credit risk considerations in the banking industry.

For example, we would note that collateralization is only one of many tools available for managing risk, especially credit risk, and that no cost-benefit argument has been made for focusing on this single method. Significant collateralization requirements would certainly add to cross-border costs, yet there is no indication in the Standards Report as to how such provisions would enhance safety and soundness. Additional costs would seem to do little to make European markets attractive to global investors, so we, as affiliates and clients of European agent banks and investment banks, would welcome greater flexibility as well as cost-benefit justification in the eventual standards.

Separation of infrastructure from intermediary services

It is not clear to us how combining and equating the services offered by an infrastructure organization with services offered by a commercial bank for regulatory purposes will serve to reduce risk. In our domestic U.S. market, we have, and much prefer, a securities settlement model where the utility functions of a central infrastructure organization are complemented by the competitive services of highly regulated intermediaries. Furthermore, we can find no reference in the report to suggest that any of the entities, infrastructure or intermediaries, is under-regulated, and that customizing regulatory requirements to the particular types of entities are any source of risk.

We believe the avoidance of credit risk-taking by infrastructure organizations and great competitiveness among intermediaries are desirable elements in the model that we have found to be most directly beneficial to investors. The notion of equivalent roles between large intermediaries and core infrastructure organizations may cause a greater likelihood that core entities seek to move into new areas of risk, as they attempt to mirror the greater flexibility that commercial entities need and protect themselves for, in their highly competitive market. As an ironic twist and no doubt an unintended consequence of such a “functionally regulated” approach, it seems the standards could thus provide greater leeway than exists today for Central Securities Depositories to take on greater risk — risks that would be better managed by, and therefore be more appropriately left within, the commercial banking sector.

Payments

To some degree, the Standards Report's references to the payment component of securities settlement seem less fully considered, including the role of cash and/or credit in the delivery-versus-payment process. Indeed, in approaching Eurozone settlements on behalf of external clients, we as non-EU intermediaries must incorporate the further complications of cash reserve requirements and linking our European securities settlements with foreign exchange settlements. The SIA's own analysis of challenges the U.S. financial market participants would face in shortening our settlement cycle to T+1 underscored the need to anticipate these perhaps more global payment aspects in securities settlement reforms. Those issues were found to be quite complex. Regrettably, we have not as yet been able to fully resolve these issues for our market. We would welcome a concerted effort with the ESCB and CESR to help in their resolution.

In conclusion, we appreciate the invitation to offer our perspectives within the ESCB and CESR consultation, and would welcome the opportunity to engage in further dialogue and discussion on the points raised in this letter. We stand ready to work with you to realize global principles for cross-border practices, especially within Europe and between Europe and the Americas, through collaborative and pragmatic steps.

Sincerely,

John Cirrito
Chairman
Cross-Border Subcommittee of the Operations Committee
Securities Industry Association