To: Working Group of ESCB and CESR
Attention: Messrs E. Kazarian and C. Crüwell
From: ABN AMRO Bank N.V.

Dear sirs,

By this electronic mail message we react upon your call for input to the work on clearing and settlement by the Working Group of CESR and ESCB, as it was made by your communication of 15 March 2002, referenced CESR/02-005b.

Before all, we would like to express our appreciation for the fact that CESR and ESCB have bundled their capabilities to jointly produce – complementary – feedback to the European Commission. This initiative, by the mere fact of being a joint one, has the potential to introduce more convergence as from the start. We think that in a complex matter as clearing and settlement the prevention of unnecessary divergence is of great importance.
It is for that very reason too, that our input starts by pointing at some opacity in the assignment of the Working Group. From the press release of 25 October 2001, we understood that the assignment was "to conduct joint work on issues of common interest in the field of securities clearing and settlement systems", leading to "the establishment of standards and/or recommendations for securities settlement systems and for central counterparties at the European level". Your communication of 15 March 2002 adds thereto that "the Work of the Group should be viewed in the context of the overall efforts by public authorities to ensure the efficient and proper functioning of securities clearing and settlement arrangements". Subsequently, it mentions the particular interests of the ESCB – smooth execution of monetary policy, correct functioning of payment systems, and financial stability – and of the CESR – maintaining confidence in the safety and reliability of systems in order to maintain market efficiency and ensure investor protection –. By not making the slightest reference to the main goal of the European Commission, the risk is introduced that at the lower levels of the recommendatory chain the focus is lost on what it is all about, and consequently that efforts become prone to serve disparate goals. The main goal of the European Commission, as we understand it, is to arrive at an integrated internal market for financial services, effective post-trade processing being one of the essential conditions to the existence of such integrated internal market. The current exercise of the Working Group is aimed at the provision of the Commission with feedback. Therefore, our advice is to consistently reiterate the main goal of the Commission in order to keep the right focus in any effort that is made, at least as long the Working Group is not explicitly given another or secondary assignment.

Keeping our focus upon the disparity between national and cross-border settlement in Europe, as the Commission is supposed to do, we want to emphasize that the disparity in post-trade processing explains a part only of the reasons for cross-border investment services involving higher cost than their national equivalents. Another, and sometimes even more important, generator of additional cost, that is incurred if an investor wants to buy or sell securities of a non-domestic issuer elsewhere in Europe (Euroland), comes from the fact that usually his broker has either to enlist a non-domestic correspondent broker in order to buy or sell the securities in their home market, or, if the securities are parallel listed on the home market of the investor, he will usually incur higher liquidity cost, because liquidity is lower than it is in the home market of the issuer. The point which we want to make is that not the impression should arise of all disparity in investment services throughout Europe being solved if clearing and settlement should have become fully integrated, as it is for instance the case in the US with DTCC. Far from that.
On the other hand, a comparison with payments is absolutely positive for cross-border (Euroland) securities order-execution, including clearance and settlement. For the larger securities deals the additional cost for a cross-border execution usually stays under 50%, gradually rising to somewhere around 150% as deals become smaller.

Another general remark which we want to make, in particular because of the involvement of the regulatory factor in your Working Group, is that ample attention should be paid to the subtile balance between regulation and competition. Competition between securities exchanges has as yet led to a number of achievements fitting surprisingly well into the goal of an integrated internal market for financial services. New (electronic) trading venues of a pan-European reach came into existence, competing with existing exchanges, and many of the more liquid European stocks are now traded on competing existing and new exchanges, alltogether resulting in a "top league" of European stocks for which the distinction between national and pan-European has been almost eliminated, their clearance

and settlement included. Moreover, the mergers under the umbrella of Euronext will also let fall into oblivion the national character of the constituting local markets and infrastructures. We think it is important that where market forces can do the job, the legislators and regulators will concentrate upon the safeguarding of the necessary level playing field, upon transparancy, and refrain from more direct measures that could paralyse entrepreneurship.

In connection to the latter observation, we want to conclude our general remarks by expressing our solicitude about the linkage between exchanges and systems for clearance and settlement. It may be true that such linkages could contribute to the overall efficiency of the integral value chain from the initiation of the order to the settlement of the resulting trade, we think that meanwhile there exists a manifest risk of competition between trading venues being frustrated by such integral governance by for-profit companies over the complete value chain. Clearance and settlement systems should be independent entities, may be competing for-profit companies or member-owned not-for-profit institutions, and anyhow they should be equally accessible to every market participant meeting objective and transparent criteria of access, other systems included.
To this view we want to add that special caution is needed if CSDs intend to deploy commercial activities in addition to their basic tasks. The offering of custody services could be such commercial activity. In case of exchange owned CSDs, we are of the opinion that the combination as just mentioned should be prohibited. Even if CSDs are independent entities the possibility of any cross-subsidizing should be prevented by demanding a clear financial segregation and transparancy between the utilitarian and commercial tasks.

Starting from our preceding remarks, some of the answers to your “issues for further consideration” are made somewhat easier, or they have already been given. Below we will consecutively adress these issues.

Some issues, in particular the ones regarding open and non-discriminatory access, will demand legislation. Other issues, in particular the ones regarding – potential – abuse of specific competitive positions could be simply tested by the appropriate regulators on compliance with existing legislation. Finally, we think that issues of interoperability should be left to market participants, for whom in specific cases authorities could play a catalyst role.

We fail to see the point in your rather detailed questions about the scope. As we already expressed, the Working Group should focus on the integration of the internal market, in particular meaning that cross-border transactions within the Eurozone are demanding explicit attention. All parties involved in post-trade processing are in our view concerned, and whether to differentiate between the various financial instruments seems to us more a practical matter of setting priorities than finding formal reasons to exclude or include something.

Your objectives have been defined in such a broad sense that they cover almost anything, except that we missed a clause referring to the support and encouragement of competition, which in not a few cases would produce a leaner approach than trying to mitigate the symptoms of a lack of competition by all kind of detailed regulation.

We are not aware of any discriminatory conditions of access, at least not for institutions of our category, observing at the same time that conditions which have been properly made for the sake of the reduction of risk could be perceived by smaller participants as being discriminatory. However, we want to emphasize that the absence of discriminatory conditions does not automatically involve a truly level playing field. We refer to the barriers which are listed in the Giovannini report, reflecting all kind of local differences and thus creating threshholds to new entrants from outside the “homemarkets”.

The dominant negative factor in the existence of various different jurisdictions and legal systems is cost, the money that has to be spent to be sure that legal risk is under control. As far as custody is concerned the most important issue is how investors are protected against a failing intermediary in the chain. Preferably, this issue should be adressed by common legislation. We suppose that this is referenced by segregation of assets. In the context of the current assignment, we do not understand why reconciliation of positions is mentioned as a crucial issue. As such it is utterly important and it should always be effected as soon as possible. In our view however, prompt reconciliation of positions always is a matter of bilateral agreements.

From the various issues which you mention with respect to settlement risk, we want to emphasize the importance of the possibility to use central bank money with clearing houses and central securities depositories. We would like to add as an important other issue the efficient intra-day allocation to clearing houses of collateral that has been deposited with an NCB. We are of the opinion that as long as there does not exist something like a European CSD, the ESCB could play a pivotal role in the efficient allocation of collateral.

The main factors to be considered in respect of operational risk are continuity in relation to contingencies, the access conditions, and last but not least vigilant regulators.

We agree to the observation that longer settlement cycles increase risk and shorter ones increase the default rate. In essence it is a matter of technical advance. Current systems and market practices are to a large degree dictated by the state of the technology. Moreover, what is economically viable for a high value settlement, is not so for a low value settlement, simply because of the relative importance of the factor of cost. As technology advances, prices will go down, and tomorrow's retail setllement will be effected in the same way as today's wholesale settlement.
However, we fail to see the relationship of this most interesting matter to the issue of harmonization. Harmonization is particularly important to prevent cross-system settlements from unnecessary delays because of the output of one system arriving too late for being processed in the other system. It is evident that shortening of the cycles within the day will also reduce the delays being caused by a lack of synchronization.

Sincerely yours,

ABN AMRO Bank N.V.