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7 May 2002

Mr Christoph Cruwell
By email to secretariat@europefesco.org

Mr Elias Kazarian
By email to elias.kazarian@ecb.int

Dear Sirs

CESR Joint work of the European System of Central Banks and CESR in the field of clearing and settlement

APCIMS-EASD is the Association for the European Securities Industry brought together by the merger of the Association of Private Client Investment Managers and Stockbrokers and the European Association of Securities Dealers. The Association operates out of offices in London and Brussels and aims to promote the European investment and securities industry, with a collective view of practitioners from across EU member states. Attached at Annex A please find a list of members of APCIMS member firms and a list of EASD member firms. At Annex B is a note summarising the objectives of APCIMS-EASD.

We are grateful to be given the opportunity of responding to this call for contributions and we can confirm that we are an interested party. You may like to know that we have formulated this response following a detailed discussion amongst members of our EU Clearing and Settlement Strategy Group ("the Group"). The Group was set up earlier this year with a specific remit to co-ordinate responses to consultations on this subject coming out of the European arena. On the Group are representatives from a broad range of firms and institutions including CREST, Virt-X, independent consultancies, private client stockbrokers and internationally active banks. We also have as an observer a representatives from the Bank of England and we also have a representative from the Financial Services Authority. You will therefore appreciate that our remarks are drawn from a wide audience representing a very broad range of industry views.

We have comments in several general areas which are listed below, and our responses to the questions raised as issues for further consideration are at Annex C. We welcome this joint project being carried out by the ECB in collaboration with CESR. Clearly this is one of several projects and initiatives on the important subjects of clearing and of settlement. We note that the ECB/CESR group have taken as a starting point the CPSS/IOSCO work, the analysis of central counterparties (CCPs), and the Giovannini Group Report. We note also the very large amount

of work already undertaken by industry representations in responding to these various initiatives and previous consultations.

We have the following other general comments.

1. Competition

We strongly support the principle that there should be competition amongst market service providers and believe that this principle should be upheld in the field of clearing and settlement. We believe that neither monopolies nor duopolies provide a sensible structure for market participants nor consumers. In the context of clearing and settlement, we firmly believe that market participants must be able to choose whether to use just one clearer and one settlement agent.

Competition will inevitably lead to a reduction in numbers and the development and availability of a number of central counterparties has been a welcome recent development because they lead to choice. We therefore favour building links wherever possible between different systems ie we believe that there is a need to promote interoperability.

2. Standardisation

We see a strong role for regulation, particularly in ensuring consumer access and in relation to standardisation in the transfer of information, connectivity and messaging.

3. Scope and Focus

We believe that the overall objective should be to look at the complete chain from the time a trade is struck, to the stock being held in custody. It will, however, be necessary to draw distinctions between the various levels in the chain otherwise it will be difficult to set standards and working practices that can be agreed. We recommend that the ECB/CESR should focus on the processes of clearers where there are legitimate complaints such as different costs, timescales for clearing, different rules and margining requirements.

4. Integration

While we accept that some believe that there should be one clearing and settlement system for Europe, we consider that this is unlikely to be achieved. In fact we are concerned that the strong commercial interests on either side of this argument are so great that pursuing this as an objective could actually result in no practical movement from the current situation. Realistically the aim should be to bring about a more integrated market and that we should work towards linking systems, opening up access and harmonising requirements.

5. Definitions and understanding of terminology

We recommend that the ECB/CESR group should provide a list of definitions of commonly used terms. For example, we believe that even such terms as "clearing" and "settlement" are understood differently in different member states.

6. Dematerialisation

The issue of dematerialisation is particularly difficult and we do not wish to go into all of the relevant issues here beyond noting the need to improve reconciliation performance. For example, we are aware that various custodians can recommend or suggest to a client that they use a particular clearing bank for certain securities when this is not in fact possible.

7. EU time zones

The differences across UK and central European time zones adds a complicating factor when settlement target times are set. We believe that the ECB/CESR group could usefully set out a proposed solution to this difficulty.

8. Giovannini Report

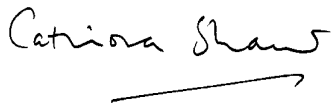
Our Group have found the Giovannini report to be generally a useful and informative analysis. But we found some of the conclusions to be naïve. In many cases market forces rather than regulatory actions can provide the best solution.

The long-term goal should be for linkages between clearing systems and a choice of settlement systems.

We would have hoped that with such a very large number of views already in the public arena that the ECB/CESR initial report would have been able to identify the issues it believes need to be addressed. We do hope that the group will move very quickly from this initial consultation to a much more advanced stage and decide upon which regulatory issues it can quickly progress and which are, perhaps, legal or commercial and will take longer to resolve or, are outside the regulators' remit.

We hope that this contribution to the ECB and CESR Project Group is helpful. Please do not hesitate to contact me if you have any comments or questions about any aspect of our response.

Yours sincerely



Catriona Shaw
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ANNEXE A

ASSOCIATION OF PRIVATE CLIENT INVESTMENT MANAGERS AND STOCKBROKERS
MEMBERSHIP 2001/2002

Ordinary Members

Abbey National City Deal
Aberdeen Asset Managers Ltd
ADM Securities
Affinity Investment Management
Aitchison & Colegrave Group Ltd
Allenbridge Group Plc
Andrews Gwynne & Associates
Ansbacher & Co Limited
Arbuthnot Fund Managers Ltd
Arnold Stansby & Co
Ashburton (Jersey) Ltd
Ashcourt Asset Management
Astaire & Partners Ltd
Atkins Bland Ltd
Barclays Private Bank Ltd
Barclays Private Bank & Trust Ltd
Barclays Stockbrokers
Barratt and Cooke
Berry Asset Management Plc
Blankstone Sington
Brewin Dolphin Securities Ltd
(inc Stocktrade and Wise Speke Ltd)
Brown Shipley Investment Managers
BWD Rensburg Ltd
Cambridge Investments Ltd
Campbell O'Connor & Co
Carr Sheppards Crosthwaite
Cave & Sons Ltd
Cazenove Fund Management Ltd
Charles Stanley & Co Ltd
(inc Torrie & Co)
Charles Schwab Europe
Cheviot Capital Ltd
Chiswell Associates Ltd
Christows Ltd
C Hoare & Co
City Asset Management plc
Close Fund Management Ltd
Close Private Asset Management Ltd
Collins Stewart (CI) Ltd
Comdirect
Credit Suisse (UK) Ltd
Cripps Portfolio Limited
Cunningham Coates Ltd
Daniels Holt
Davy Stockbrokers
Deutsche Bank Private Banking
Direct Sharedeal Limited
DLJ Direct Ltd
Douglas Deakin Young Ltd
Durlacher Ltd
E*Trade (UK) Ltd
Edward Jones Ltd
Ely Fund Managers Ltd
Everys Solicitors
F H Manning Financial Services Ltd
Farley & Thompson
Fiske Plc
Fyshe Horton Finney Limited
Generali Portfolio Management (UK)
Gerrard Ltd
Goodbody Stockbrokers
Goy Harris Cartwright & Co
Global Asset Management Ltd
Halifax Share Dealing Ltd
Harris Allday
Hargreave Hale Limited
Hargreave Lansdown Stockbrokers
Hedley & Co
Henderson Global Investors Ltd
Hichens Harrison & Co Plc
Hill Martin (Asset Management) Ltd
Hill Samuel Bank (Jersey) Ltd
Hoodless Brennan & Partners Plc
HSBC Bank plc, Stockbrokers
HSBC Investment Management Ltd
I A Pritchard Stockbrokers Ltd
Iain Nicholson Investment Mgmt Ltd
Idealing.com
iimia Plc
Insinger Townsley
Irwin Mitchell Solicitors
Invesco Private Portfolio Management
James Brearley & Sons Ltd
J M Finn & Co
J O Hambro Investment Management
J P Morgan Private Bank
James Sharp & Co
KAS Bank N.V.
KBC Peel Hunt
Killik & Co
Kleinwort Benson Private Bank
Laing & Cruickshank Investment
Management Ltd
Lawrence Graham
Leopold Joseph & Sons
London York Asset Management Ltd
Lloyds TSB Stockbrokers
M D Barnard & Co Ltd
Man Securities Ltd
Martin Currie Private Clients Ltd
Merlin Financial Consultants
Merrill Lynch International Private Bank
Merrill Lynch Investment Managers
Morgan Stanley Quilter
Murray Beith Murray Asset Mgmt
NatWest Stockbrokers
NCL Investments Ltd

Nichols Williams Durrant & Co Ltd
Noble Asset Managers
Norwich & Peterborough
Sharedealing Services Ltd
Oaktree Investment Management Ltd
Options Direct (Europe) Ltd
Pershing Ltd
Philip J Milton & Co Plc
Pilling & Co
Popes
Principal Investment Management Ltd
Prudential Bache
Ramsey Crookall & Co Ltd
Raphael Tutton and Saunders Ltd
Rathbone Investment Management
Raymond James Killik Ltd
Redmayne Bentley
Reyker Securities Plc
Robson Cotterell Ltd
Rowan Dartington & Co Ltd
Royal Bank of Canada Investment
Management (UK)
Ruffer Investment Management Ltd
Russell Wood Ltd
Schroder & Co Ltd
Selftrade UK Ltd
Seymour Pierce Ellis
Total: 154

S P Angel & Co
S G Investment Management Ltd
Sharepeople Limited
Shore Capital Stockbrokers Ltd
Smith & Williamson Investment
Management
Southard Gilbey McNish & Co
Speirs & Jeffrey Ltd
Standard Bank Stockbrokers (CI) Ltd
Stewart Ivory Wealth Management
StockAcademy Ltd
T.D. Waterhouse
Taylor Young Investment
Management Ltd
Teather & Greenwood Ltd
The Share Centre Ltd
Thesis Asset Management Plc
Thornhill Investment Management
Tilman Asset Management Ltd
Tilney Investment Management
Truro Stockbrokers
UBS AG Private Banking
Vartan & Son
Walker Crips Weddle Beck Plc
Williams de Broe
W H Ireland Limited

Associate Members

Aitken Campbell & Company Ltd
Archipelago Europe Ltd
Bank of Scotland
Barlow Lyde & Gilbert
Beeson Gregory Ltd
S J Berwin & Co
BPP Hyperion Training
Bristol & West
Cantor Index Limited
City Consultants
City Markets
ComPeer Ltd
Computers in the City
Consort Securities Systems Ltd
Credit Suisse First Boston Europe Ltd
CRESTCo Ltd
Deloitte & Touche
Depository Trust Company
DLA
Dresdner Kleinwort Wasserstein
EO Plc
Exact Technical Services
Exchange Data International
Foort Mercer Solicitors
Fortis Clearing London Ltd
Hemscott Plc
Instinet Europe Limited
Interactive Investor Plc
Investmaster
Investment Sciences Ltd
JHC Plc
KPMG
Knight Securities International Ltd
Lawshare Ltd
Market Touch Plc
Marsh Finpro
MBA Systems Ltd
MeesPierson
Merrill Lynch International – MLX
Market Edge
Minnie Business Systems Ltd
Monument Derivatives Ltd
NASDAQ Stock Market
OFEX Plc
On Bourse Limited
Park Place Capital Ltd
Penson Worldwide Settlements Ltd
Peter Evans & Associates Ltd
PricewaterhouseCoopers
Pulse Software Systems Ltd
R A McLean & Co Ltd
Royal Bank of Scotland City Markets Group (incorporating NatWest City Markets Group))
Schroder Salomon Smith Barney
Securities Institute
Stuchfield Consultancy
Summerson Goodacre Ltd
SunGard Investment Systems UK Ltd
Swift Sc
Synagir UK
Telekurs (UK) Ltd
Thomson Financial
Virt-x
Web Trading Services Ltd
Wilco International Retail Systems Ltd
Winterflood Securities Ltd
Wragge & Co

Total: 65

APCIMS-EASD Members

ABN AMRO Equities (UK) Ltd
Altium Capital
Aurator Asset Management Ltd
Baader Wertpapierhandelsbank AG
Banca del Gottardo
Brook Partners Limited
CA-IB Investmentbank AG
Deloitte & Touche Tohmatsu
Delta Lloyd Securities
EVLI Securities
Fontana e associati
GCI Financial
Granville Baird
Lombard Odier & Cie
Morgan Stanley & Co International Ltd
Petercam SA
Prager Dreifuss
PricewaterhouseCoopers
Puilaetco
Quoted Companies Alliance
Rabo Securities NV
Solidarietā & Finanza
Sullivan & Cromwell
Telfa
Travers Smith Braithwaite
Verband unabhängier Vermögensverwatter

Total: 26

ANNEX B

APCIMS-EASD

APCIMS was set up to represent a sector of the financial services industry to all relevant authorities, governments and institutions who decisions, rules, regulations or Acts affect, directly or indirectly, their business. All full UK members are involved in the securities industry but in addition there are nearly 60 Associate members including account firms, law firms and software houses. For them APCIMS:

- Constructs the collective view of the community and represents it to regulators, exchanges, banks, clearing systems, European institutions etc. as relevant.

- Provides a focus for the business, taxation and regulatory issues of its members and a means to bring about the necessary changes.

- Undertakes seminars, workshops and other events at are subsidised rate for members which are relevant to firms' business and for the continuing professional development of their staff.

- Produces a monthly newsletter containing important information on changes or decisions.

- Produces a quarterly QReview journal.

- Runs a website which attracts significant interest from investors and therefore business to members.

- Runs a heavily subsidised "big issues" annual conference.

- Provides a focus for expertise, exchange of views amongst members and a networking opportunity.

The former full (or dealing) members of EASD and the associate (or non-dealing) members who now become members of APCIMS-EASD are not necessarily going to be interested in some of that which is specific to the UK operation. For them, APCIMS-EASD:

- Constructs a collective view of practitioners from European countries and represents this view to the European Commission, European Parliament and other relevant European institutions.

- Actively influences the many changes that are affecting all European markets brought about by the 40 changes highlighted in the Financial Services Action Plan which is scheduled to be in place by 2005.

- Provides access to European institution decision makers in a way that has not been available in the past.

- Undertakes events which are relevant to a firms' business, at a subsidised rate.

- Produces a monthly newsletter (EuroNews) containing important information on changes, decisions and other matters which will affect their market.

- Creating a network of professionals and provides a focus for expertise and exchange of views amongst members.

- Highlights the differences in practices in different European countries and thereby be able to advocate the most sensible route for change.

- Produces relevant publications.

- Runs a heavily subsidised "big issues" conference.

ANNEX C

APCIMS-EASD SPECIFIC COMMENTS ON QUESTIONS RAISED IN THE ECB/CESR PAPER

Question 2.1 What should be the legal nature of the recommendations and/or standards to be issued by the Group? Are there issues for which a European Legal instrument is deemed appropriate? Are there recommendations and standards that should be adopted by national law?

APCIMS-EASD Comment: We believe that there are many issues where EU legislation may be appropriate such as the issue of having "freedom of choice". We strongly support the harmonisation of standards while much of the detail can best be addressed through harmonised regulations. We see a particular need for standardisation in respect of the transfer of information, connectivity and messaging.

The user requirement is to trade on the Exchange of their choice, clear where they wish and settle in the system they choose, at a reasonable cost and within a sensibly regulated environment.

Question 2.2 Addressee: Who is the appropriate addressee of the possible standards, the regulators, the systems, the operators or the users?

APCIMS/EASD Comment: All interested parties need to be addressed and to be given the opportunity to contribute. We believe that it is particularly important to ensure that the users are involved throughout the process. We are aware, for example, that costs of using the different systems are often much higher than reported by the operators. This is due to a variety of reasons, varying from local legal requirements through to minimum tariffs and services set at too high a threshold.

Question 2.3 On the Scope of the ECB/CESR group's work

APCIMS-EASD Comment: The overall objective should be to look at the complete chain from the time a trade is struck, to the stock being held in custody. It could be argued that the custodial function itself is not part of the 'safely completed trade' cycle, but this would be too simplistic. CSD's operate as settlement agents and custodians. UK registrars/issuers are involved directly in the processing chain, and can offer custodial services, as well as being the repository of legal title. Professional custodians have an involvement as direct or indirect members of the various depositories. In our view it is impossible to exclude any of these functions, so we suggest that the scope of the group's work should encompass clearers, ICSD's, CSD's, registrars/issuers, professional custodians, and payment agents.

We believe, however, that it is necessary to draw distinctions between the various levels in the chain, otherwise the complexity of drawing up standards and working practices to be agreed by all those involved would be impossible. The process obviously starts from the execution and confirmation of the trade, which itself may be influenced by clearing, settlement, and custodial arrangements. It is the next stage – the clearing process – that provides the first main opportunity to reduce risk and cost by netting trade obligations, and the ability to net cross-border trades would be a significant achievement. We therefore believe that clearing should be looked at as a function in its own right, irrespective of who operates the clearing service.

We would further suggest that this principle is also applied to the settlement (CSD) function, where open standards should be encouraged, irrespective of who operates the function. A CSD or ICSD, by definition, operates as a depository, or custodian, having dealt with the transfer of stock against cash. This is, of course, separate from the function of the professional custodian, who acts as an agent for the customer, interacting with the various CSD's, and providing a central record of the customer's assets, and dealing with benefits, tax reclaims, and so on.

As far as which securities should be covered, it is difficult to see how 'one size fits all', certainly in the early stages. We suggest that the original focus should be on equities, and that other instruments could be incorporated as settlement cycles converge.

Question 2.4 Objectives

APCIMS/EASD Comment: We would question whether one of the objectives should be integration. What is meant by the term integration? Integration can refer to the merger of all clearing and settlement systems versus the integration of rules, information and costs. A clearer definition is required.

On the creation of a level playing field between participants and service providers, irrespective of their legal status or their geographical location – there is a clear need to include mention of a level playing field for the customer also.

Overall the customer and the company have been omitted from these objectives while the issues of transparency and access have not been reviewed at all. The customer needs to clearly understand the type of service and product they are receiving as legal risks create the ambiguity of 'who actually owns what security'.

There is also no mention of costs here and overall we believe that key is for cheap, easy, fair access for customers to trading systems as well as the clearing and settlement systems in the jurisdiction of their choice. Customers and companies have also largely been omitted from the objectives.

Question 2.5 Access Conditions Are you aware of access conditions to specific service providers which could be considered discriminatory? If so, where do the main problems lie? Do they relate to the access criteria of the system or to other conditions such as operational features, If so, which ones?

APCIMS/EASD Comment: We believe that the major clearers including Euroclear and Clearstream may argue that there is competition and that their access conditions are fair and non discriminatory. But, the real key lies in the fact that Stock Exchanges continue to dictate where firms must settle their transactions. The best solution is therefore to link CCPs. Taking the experience in the US, it is interesting to note that its settlement process is rather inefficient, but its clearing operation which handles some 800 billion trades (in a year?) is hugely successful. It is unlikely given the present structure in Europe, that we will (or should try to) copy this model, but we should aim for interoperability and links between different clearers and settlement systems.

We recommend that ECB/CESR should focus on the processes of clearers where there are legitimate complaints, eg that there are different costs, timescales for clearing, rules and margin requirements. We believe that it is in these areas that legislation or preferably CESR regulations might usefully play a role.

Question 2.6 Risks and Weaknesses

APCIMS/EASD Comment: We believe that the Giovannini Report covers the risks and weaknesses admirably well. We support the following text which is an extract from 'Cross-Border Clearing and Settlement Arrangements in the European Union' by the Giovannini Group.

The greater complexity of cross-border transactions, and equity-based transactions in particular, means that their settlement (and clearing to a lesser extent) involves credit risk beyond that normally associated with a domestic settlement. In addition, the relative complexity of cross-border trades involves a higher level of operational risk.

Credit risk that is equally associated with clearing and settlement of both domestic and cross-border trades includes:

- **principal risk** which is the possibility that either counterparty to the trade will fail to meet his obligations, which can be addressed by moving to a DVP system in the CSD concerned;
- **replacement risk** which is the possibility that either counterparty will fail to meet his obligations on the due settlement date and leaving the other counterparty with the cost of replacing, at current market prices, the original transaction; this risk can be addressed by proper internal risk management when cleared through a clearinghouse with collateralised exposure or within the CSD;
- **liquidity risk** which is the possibility that either counterparty will not settle an obligation for the full value on the due date but at some unspecified date thereafter; this risk can also be addressed by proper internal risk management when cleared through a clearinghouse with collateralised exposure or within the CSD.
- **cash deposit risk,** which can be considered as a specific form of liquidity risk arising from the need to hold cash balances with an intermediary for settling the security transactions.

The sources of credit risk that are more specifically associated with cross-border securities transactions include:

- **custody risk**, which is the possible loss of securities held in custody because of insolvency, fraud or negligence of the custodian or sub-custodian. As is clear from the channels described above, there is greater reliance on custodians, or multiple custodians, for cross-border settlement. Therefore, this category of risk is increased beyond the level for domestic settlement. The key response to this risk is segregation of customer securities from the "owned" securities of the custodian. The availability of operational links between national CSDs would also address this risk by reducing the need to use custodians.
- **foreign exchange risk**, which arises from possible movements in exchange, rates between the trade date and the settlement date. In addition, liquidity risk can be increased in a multi-currency environment.
- **legal risk**, which is the possibility of an unexpected application of a law/regulation or because a contract cannot be enforced. Cross-border settlement involves multiple legal jurisdictions, such that this risk is increased.

To sum up, the complexity of the clearing and settlement processes is directly related to the number of participants involved and a cross-border securities transaction normally involves a greater number of these than a domestic transaction. Clearly, the potential for additional risk and cost in cross-border transactions rises with the number of different clearing and settlement systems that must be used.

There is substantial diversity in the legal treatment of securities across the EU. While the law may be well understood by participants in any one market, the scope for complexity and uncertainty in the legal treatment of securities where more than one jurisdiction is involved leads to an inevitable lack of clarity for all. Three particular dichotomies should be mentioned:

1. Equities are very different from debt securities. Equities are creations of national legislative regimes. Every EU corporate can only issue shares under and in accordance with the law of its country of incorporation. No matter where and how these shares are traded, or rights in them are traded, one can never completely escape from the national regime that created them. Debt securities, by contrast, can be issued with a free choice or form, terms and conditions of the debt, including where it falls to be paid, and what is its governing law.
2. Some EU legal systems recognise in certain circumstances a difference between ownership of a security outright and an entitlement against a settlement system (or intermediary) to own such a security. Others treat the two as the same.
3. Some debt securities are physical, but most are not. Bonds may be constituted by physical paper (either held by investors, or immobilised). They may consist of interests recorded in an accounting system that are deemed to replace physical papers. They may be issued in a gully dematerialised form, and recorded in the books of a system, or of an intermediary, or recorded in a register.

Question 2.7 Settlement cycles

APCIMS/EASD response: We believe that more work needs to be carried out before we can confirm that firms could cope with T+1 using a CSD that provides batch processing. It is worth noting that the US experience highlighted the point that while larger firms could cope, it could damage smaller firms. Now that CCPs are developing and thus reducing the risk, is there any need to move to T+1? We would suggest that T+3 may be a sensible compromise between reducing risk and allowing sufficient time for settlement. ECB/CESR could usefully compare fail rates between Frankfurt (T+2) and London (T+3) where the former is believed to be more than 10% and the latter ie London is less than 3%.

We are also aware that since 11 September, there has been a re-evaluation of the desirability of shorter settlement cycles with concerns raised by many that T+3 may be a more appropriate and pragmatic settlement standard.

The expression "right governance" is used here to mean that the clearing and settlement entities need to either be commercial competitive operations or owned and governed by their users. Any other model will inevitably result in higher costs and problems for the users.

Question 2.8: Structural issues:

APCIMS/EASD response: We note that there is an implication in the question that what was desired was an "integrated market". We believe that it is more realistic to seek a more integrated market and that we should work towards linking clearing systems. Provided there is sufficient transparency in the processes, there should be less concern about any need for seeking a reduction in the number of settlement systems. We believe that it does not matter whether the structures are commercial entities or utilities provided the right governance and risk management are in place.