JOINT WORK OF THE EU EUROPEAN SYSTEM OF EUROPEAN CENTRAL BANKS AND THE CENTRAL COMMITTEE OF EUROPEAN SECURITIES REGULATORS IN THE FIELD OF CLEARING AND SETTLEMENT

Answer by Deutsche Bank AG

2.1 Nature of the recommendations:

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?

Deutsche Bank well appreciates that market participants have the opportunity to comment on the legal nature of their regulation. Nevertheless in the current state a judgement on the nature of legislation would be precipitate. We believe that the form of regulation should depend on the final formulation of the recommendation / standards and not the reverse. Thus, the nature of recommendation should be deduced from the inefficiencies investigated for example to the different barriers identified by the work of the Giovannini Group.

2.2 Addressee:

Who is the appropriate addressee of the possible standards or recommendations to be drawn up by the Group: the regulators, the systems, the operators or the users? In such cases where standards and/or recommendations are addressed neither to regulators nor to legislators, what are the appropriate incentives for their implementation and compliance?

For those issues which solely concern insufficient harmonisation e.g. in terms of taxation or changes in legal systems (transfer of ownership) the addressee can be the regulator or the legislator only.

The reason for this question is in our view based on the diversity of securities markets in Europe while market participants offering C&S services can only be vaguely distinguished. Europe has experienced a growing interdependence between service providers which results in a commingling of services a single institution offers (trading, clearing, settlement, safe custody, banking services) – not to the harm of the European capital market.

Incentives for implementation if the addressee is not a regulator nor legislator can only be market forces. We believe that the main driver for enforcing the implementation of the upcoming recommendation would be competition between the market participants. Leveraging free market forces should be the aim of any recommendation to be issued by the regulator.

2.3 Scope:

Do you agree that the scope of the Group's work includes any entity providing clearing and settlement services or associated aspects and is not limited to any particular type of service provider? More specifically, do you agree that central securities depositories (CSDs), international central securities depositories (ICSDs), CCPs, custodians and registrars are included? Do you think that some standards should apply on a differentiated basis to these parties given that the scope of their business is not directly comparable? Should standards apply to other parties? If so,

which standards and to which parties? With regard to custody and safekeeping services, what are the advantages or disadvantages of a distinction being drawn between custody services, on the one hand, and clearing and settlement on the other? Do particular considerations apply where custody and safekeeping services are provided by credit institutions or investment services firms? With regard to the securities covered, do you agree that sovereign and private debt, equity and other securities, as well as depository certificates, receipts, derivatives, etc., are included, or where would differentiation be necessary? Should some standards/recommendations be specifically addressed to cross-border transactions? If so, which ones?

The groups' efforts should be prioritised along the relevance of existing barriers for an integrated capital market. Therefore, the European cross border clearing & settlement should benefit first from any recommendation. The domestic clearing & settlement arrangements instead should not be of concern as they are already efficient and scalable. As ICSDs nowadays also act as CSDs, the scope has to inevitably encompass all kind of entities providing services in regard to clearing & settlement.

Any recommendation should guarantee the flexibility to differentiate according to the service level and according to the underlying goal. In our view the highest priority should lie on equities clearing & settlement, since here fragmentation is hindering efficient cross border transactions.

2.4 Objectives:

A priori, the objectives of central banks and securities regulators in the field of securities clearing and settlement systems could be summarised as follows: 1) risk mitigation, including investor protection, for both the system and the users; 2) efficiency, including for cross-border activities; 3) creation of a level playing field between participants and service providers, irrespective of their legal status or their geographical location; 4) promotion of integration of the EU securities markets infrastructure. Do you agree? Do you consider that these objectives are sufficient?

We expressly declare that the presented objectives are supported by Deutsche Bank. Nevertheless, it may be worth considering whether certain objectives should be awarded a higher weighting compared to others. Clearly, the creation of a level playing field and the improvement of the cross border equity clearing & settlement is currently of the highest importance. In order to create a level playing field for all participants, it could be necessary to examine the clearing & settlement arrangements not only from a perspective distinguishing between a group of users and system providers (concerning questions of free access and egress) but also to take into account the inconsistency of each group. Unless the objectives make allowance for the fact that users sometimes can be service providers and vice versa any objective is inadequate to represent the existing market structures properly.

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 you consider that the present rules do/do not establish a level playing field in this respect? Do they relate to the access criteria of the system or to other conditions such as operational features? If so, which ones?

There are no direct access conditions that could be considered discriminatory besides criteria established to secure a well functioning of the system (e.g. capital requirements).
Indirect restrictions, for example the different access conditions to central bank money for foreign participants, should be approached.

Additionally, we propose not to limit this question to access conditions but also to egress conditions, in terms of whether participants are free to chose to use a certain service from a certain provider or not.

2.6 Risks and weaknesses:

What are the most relevant factors to risks and weaknesses in terms of clearing and settlement of domestic and cross-border transactions (i.e. legal, settlement, custody and operational risks)? As far as legal risks are concerned, what kind of problems can different legal approaches create? When looking in particular at cross-border transactions, how does the existence of different jurisdictions and the involvement of several actors such as local agents, global custodians, foreign CSDs or ICSDs in the process of cross-border clearing and settlement affect the nature and magnitude of these risks? What would be the most appropriate manner of addressing these issues? As far as custody activities are concerned, do you agree that the segregation of assets and the reconciliation of positions are the most crucial issues to be addressed? As far as settlement risk is concerned, do you agree that the definition and timing of finality (including the need for intraday settlement finality), delivery versus payment, access to central bank money as settlement assets for systemically important systems and conditions of use of central bank money versus commercial bank money are the most crucial issues to be addressed with regard to clearing and settlement of domestic transactions? What specific impact could these issues have on clearing and settlement of cross-border transactions? Finally, as far as operational risks are concerned, what are the main factors to be considered?

Europe is highly fragmented on legal and regulatory issues. This has substantial effects on the equity cross border clearing & settlement which contrary to pure domestic business is less cost effective and scalable and attracts higher risks.

Hence, the regulator should primarily address risks which cannot be prevented by the market itself. This concerns mainly legal issues such as the final irrevocable transfer and acquisition of title and the protection of assets against intermediaries' insolvency.

2.7 Settlement cycles:

What are the arguments for and against harmonised and/or shorter settlement cycles? It appears, for instance, that while a very short cycle could increase settlement default rates, a longer cycle could increase uncertainty and settlement risk. Is there a need to adopt different settlement cycles for different securities, such as for equities and government debt instruments, etc?

As soon as a certain security is traded on more than one exchange, harmonised settlement cycles are needed especially for complex trading strategies such as arbitrage. Besides this, trading within a closed system will also profit by shorter settlement cycles as this would limit market price risks. The introduction of a shorter settlement cycle depends on the systems ability to hedge the operational risk. Harmonisation of settlement cycles in Europe should be oriented at the most efficient

market (e.g. the one with the shortest settlement cycle) not the reverse. The ultimate aim would be a settlement cycle of *T+0 for all kind of securities.*

2.8 Structural issues:

The structure of the securities clearing and settlement industry in Europe has been hotly debated recently. An integrated market can be achieved via a number of routes, with concentration, interoperability and open access being the most obvious alternatives. What are the arguments, if any, for a public policy intervention relating to (i) centralised or decentralised structures for infrastructure and service providers; and (ii) the governance structure of infrastructure and service providers? Are custodians, CCPs, CSDs and ICSDs to be considered as commercial firms, driven by regular competition, or should they (or some categories of these entities) be considered as utilities whether or not they operate within a monopoly environment? Does the same reasoning apply to the provider of trading services?

A regulatory intervention to change the structure of the securities clearing and settlement industry in Europe would be counter-helpful as this would require a common understanding of the best solution for the market infrastructure . Mainly, the discussion is pending between vertical and horizontal integration. Those in favour of vertical integration believe that it is easier and more cost-effective if everything occurs in the same structure. Advocates of horizontal consolidation argue that vertical structures create comparative disadvantages for those who are outside the vertical chain.

Additionally, there is disagreement whether clearing & settlement should be run as a for-profit or as a utility business as there are benefits of competition on the one hand, and of the efficiency of unitisation on the other.

Independent from the discussion whether a horizontal or vertical integration would offer an optimal solution for the future clearing and settlement infrastructure, Deutsche Bank would like to submit an alternative approach. In order to make the European cross-border equity clearing & settlement more efficient, a central linkage of the national systems (domestic CSDs) is needed. For the users little would change as they would get access through the CSD of their choice providing one single point of access entry for domestic and European cross border business, Each CSD would maintain its domestic capability and strength. The chances of success will be even higher as less effort is made by each CSD to dominate the other. In addition, write-offs of existing investments could be avoided and additional investments for the cross border business could be minimised and concentrated at the CDS's level rather than allocated to all market participants in Europe.