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

CONTRIBUTION TO THE PUBLIC CONSULTATION OF CESR-ESCB

2.1 Nature of the recommendations

Some certain insecurity or uncertainty exist in cross-border transactions environment. In the European Union, a lack of harmonisation can be found in matters such as withholding tax treatment. Similar rules would be welcome for trading, clearing, custody and securities settlement. The same goes for the corporate actions along the European Union area.

A common European regulation framework seems more practical than different coexisting national laws. Uncertainties also exist for the different ways in which European Directives are implemented into the national laws.

As to the standards, a set of recommendations will be sufficient without being included in new regulations to be enacted.

2.2 Addresses

Both standards and/or recommendations should be addressed to regulators and legislators and also to the systems and their operators. Users role should be limited to adequate standards implementation.

2.3 Scope

The working group CESR/ECB should be ambitious and cover a wide range of topics. In this way their recommendations should be given to CSD's, ICSD's, CCP's, custodians and registrars. In like manner, the working group should deal with the clearing and settlement infrastructure because is a relevant element to achieve efficiency in the future Pan-European market. Strict standards should be designed for entities that are benefiting from a monopolistic and oligopolistic status in the market.

Even being different, custody and clearing and settlement use to be strongly interconnected activities. For that reason no distinction should be made and a common approach should be followed when dealing with these activities. However, the working group conclusions could be specifically addressed to the different categories of the Pan-European Securities Market participants. In this manner, the participants in the system would be obliged to design their procedures and infrastructures according to the new European rules and standards.

Investors should be free to choose a custodian for their clearing and settlement activities and custody services. Alternatively, they should be free to sign a contract with a different provider for everyone different function. Credit institutions or investment services companies would observe a strict capital adequacy in order to safeguard their customer's assets.

A different treatment or recommendations for different types of securities may exist.

A special attention should be paid to cross-border transactions that certainly are more complex and by far more expensive as compared with the US reference. A direct access should be provided to the Stock Exchanges and CSD's, with the necessary cautions. The markets continue asking for a fiscal treatment and withholding tax harmonisation. In a multinational environment, a necessity of harmonisation is also asked for market opening hours, trade confirmation schedules and investor's protection.

On the other hand, keeping in mind that domestic settlements don't usually convey problems in the different national scopes, regardless of the European recommendation or rule, it should not cause damages nor increase the cost to the current efficiency in the different domestic markets for the national investors.

2.4 Objectives

The stated objectives seem sufficient. To keep the retail investors process away from the institutional or professional investor's could be useful. Often the recommendations have been institutional investors looking oriented giving the impression that retail investors are not sufficiently taken into account.

2.5 Access conditions

It seems that in many markets a domestic protectionism exists that prevents an open access for other country institutions. In some cases a physical establishment is required for the market participant and not always a remote access to foreign institutions is permitted in CSD's. Even those CSD's that allow for remote access continue putting hindrances when forcing to use their proprietary systems and language that represent an additional conflict.

It would be interesting that the CSD's will use swift communication tools for the remote access. In the Pan-European environment towards we are going towards, discrimination only should be acceptable in terms of financial soundness of the participants. Gradually restrictions that demand physical establishment must be removed. Interoperability among the trading, clearing and settlement structures in the European environment will ease the efficiency and success for the cross-border transactions.

2.6 Risk and weaknesses

Insecurity exists in the cross-border environment as a consequence of the different legal framework that applies to transactions. On the other hand, the lack of a true delivery versus payment link among the different markets is a matter of concern. Always a debate is open on what is or rather how can a delivery versus payment be improved in such a way that a complete safety is guaranteed. Lack of harmonisation through

European Union Area produces contradiction between the legal provisions applied to the same issues and therefore represents an additional source of risk.

Concerning settlement risk, it is very important to define when finality is reached, including intraday settlement finality (the same can be said with respect to the central bank accounts access and the usage conditions of the central bank accounts versus those of the commercial banks).

With regard to custody risk, a regulation in the European field for segregation and reconciliation of assets is very important, just the same as specific regulations for assets protection in insolvency situations. STP and Central Counterparties Institutions (in those markets who need it) tend to reduce settlement risks. Central bank money represents the safest solution for cash settlement of the securities transactions. The commercial banks that are acting as settling agents should have in place strict measures that lead to the adequacy of their capital.

As to the operational risk, the different way of treating the corporate actions constitute a obstacle to be overcome.

A special attention should be paid to the reliability, capacity, controls, procedures, contingency plans and back-ups of the systems. Common operational standards should be established for the systems in order to get more safety for them.

2.7 Settlement cycles

Shorter settlement cycles tend to reduce settlement risk. Nevertheless, if there are no other measures to undertake this shortening without, on the other hand, damaging the operational risk, such shortening should not be recommended. Taken in account that an increasing number of securities are traded on different European Stock Exchanges or trading systems, it is convenient that the shortening of the cycles takes place at the same time. Thus, it is avoided that a same security is settled on different dates depending on the trade location. A future shortening to T+2, provided that the necessary operational guarantees are kept, would be very positive, in the context of a concerted action along Europe. At present, T+1 would be too hurried considering, specially, that forex trading require two days. Use of STP mechanisms will be necessary to undertake an efficient shortening. Also it must be taken in account the existence of different time zones and holidays in Europe.

It could be possible to consider different settlement cycles depending of the financial instrument. For instance, flexible cycles for bilateral transactions, and shorter settlement cycles for derivatives or government debt. Shorter cycles need the use of multiple batches or real time settlement. In any case, shortening cycles should be implemented in line with a decrease of the failed transaction percentages.

2.8 Structural issues

The infrastructure concentration inside the European Union is an objective. The current structure with many custodians, CSD's, ICSD's, Stock Exchanges, Central Counterparty Institutions, and so on... has built-up a competitive environment which is good as such but also very complex. Such institutions should be considered as competitive driven

commercial companies. The monopoly doesn't seem to be the best solution. Nevertheless, a strict regulation should exist with a strong supervision carried out by the appropriate authorities. This would provide a competitive, safe and sound framework. Regulation should apply to different categories including the service providers. For instance, all the CSD's should be under a similar regulation. The same could be applied in the case of Exchanges and other categories.

A user oriented approach for the governance structure of those institutions is important for the efficiency of the system. Thus, price abuse could be avoided and at the end this will turn in favour of a better efficiency.