

ESCB-CESR RECOMMENDATIONS FOR SECURITIES SETTLEMENT SYSTEMS AND CENTRAL COUNTERPARTIES IN THE EUROPEAN UNION

On 23 June 2009 the ESCB and CESR published “Recommendations for securities settlement systems and recommendations for central counterparties in the European Union”. The main aim of the ESCB-CESR recommendations is to promote efficient, safe and sound pan-European post-trading arrangements in order to facilitate greater confidence in securities markets, ensure better investor protection, contain systemic risk and foster financial stability. Furthermore, the recommendations seek to improve the efficiency of the market infrastructure, which should in turn promote and sustain wider financial market integration and efficiency in Europe.

Background

In 2001 the ECB’s Governing Council and the CESR established a joint Working Group – composed of representatives of the ECB, the national central banks and the securities regulators of the EU – to adapt the 2001 CPSS-IOSCO recommendations for securities settlement systems to the European context in order to take into account, inter alia, the complexity of the arrangements for securities clearing and settlement in Europe, its particular legal environment and the prominence of cross-border transactions. Following the issuance of the CPSS-IOSCO recommendations for CCPs in 2004, the work was extended to also cover these recommendations.

When finishing the work in the course of 2008 and 2009, the ESCB and CESR revised the recommendations, taking into account all recent regulatory and legal developments and other initiatives. In view of the financial stability risk posed by the growing scale of OTC derivatives exposures, the ESCB and CESR decided in December 2008 to address the risks of OTC derivatives when reviewing and finalising the recommendations for CCPs.

The European Commission, the Committee of European Banking Supervisors (CEBS) and relevant market participants and associations were consulted in this work. Two public consultations took place, the first with respect to the general review, and the second on specific changes introduced in relation to OTC derivatives.

Scope

The ESCB-CESR recommendations are non-binding, cover central securities depositories (CSDs) and CCPs, and are addressed to regulators and overseers who will use them as a regulatory tool.

It is important to note that while the recommendations no longer cover custodian banks, which nevertheless perform an important function in clearing and settlement, the CEBS, in cooperation with the ESCB and CESR, has conducted further work to ensure a level playing-field. In this respect, the CEBS concluded that the Capital Requirements Directive (CRD) and/or other banking-relevant regulations cover the risks borne by custodians, except where custodian banks internalise settlement activities. Following a call for evidence to assess the materiality of such settlement

and other CCP-like activities, the CEBS concluded that there is little evidence to suggest that action at a European level is needed to address this issue.¹

Main differences compared with the CPSS-IOSCO recommendations

As a general principle, the ESCB-CESR recommendations are at least as stringent as the CPSS-IOSCO recommendations. Hence, the ESCB-CESR recommendations will replace the CPSS-IOSCO recommendations in the EU context. In order to keep the linkage between both sets of recommendations as strong as possible, the overall structure has been maintained. This means that the ESCB-CESR recommendations are divided into two parts: part 1 contains 19 recommendations for securities settlement systems and part 2 contains 15 recommendations for central counterparties.

However, compared with the CPSS-IOSCO recommendations, the ESCB-CESR recommendations have added the following aspects in relation to the EU context:

- i) they refer to the need for designation under the Settlement Finality Directive and focus on the harmonisation of EU rules, which is an important issue in the achievement of a single market in financial services in the EU (e.g. by requiring CSDs to be open at least during TARGET2 operating hours; by calling for intraday finality in Europe to facilitate interoperability; by asking competent public authorities to ensure consistent implementation in the EU; and by requiring that denial of access should only be based on risk-related criteria or other criteria as set out in EU law);
- ii) they require higher levels of risk management and transparency in some areas (e.g. requiring the separation of the CCP services into a distinct legal entity; explicitly addressing operational risk stemming from exceptional external events such as man-made and natural disasters; requiring the setting-up of a second site; stipulating that a CCP should develop plausible scenarios that consider the simultaneous crystallisation of different risks; adding a requirement that a CCP should regularly test default procedures; and asking for regularly updated information on services and prices) and add specific requirements for the outsourcing of clearing and settlement activities; and
- iii) they address additional risks with respect to the clearing of OTC derivatives (e.g. CCPs should provide information on the rights of the customers of clearing members with respect to collateral and consult clearing participants on the setting-up of a dedicated clearing fund in the case of a CCP's expansion of activities to new products).

Outlook

Securities regulators and central banks are expressed their intent to integrate the ESCB-CESR recommendations into their respective assessment framework and/or practices with which they assess the safety, soundness and efficiency of the post-trading infrastructure within their jurisdiction. In some EU countries, first assessments of new systems against these recommendations are already being conducted. In the case of a pan-European system, the respective Memorandum of Understanding (MoU) between overseers had already foreseen

¹ See the CEBS's reports to the ECOFIN Council on custodian banks dated 18 December 2008 and 17 April 2009 (www.c-eps.org).

the replacement of the CPSS-IOSCO recommendations with ESCB-CESR recommendations, once the latter was adopted. It is expected that by end-2011 a first assessment of all systems within the EU will have been completed against the ESCB-CESR recommendations.

In order to achieve a level playing-field, central banks and securities regulators will cooperate with each other, both on a national and on a cross-border basis, to ensure a consistent interpretation of the assessment methodology in particular.

The ESCB and CESR are committed to conducting further work to address, for example, the growing interdependencies between systems and the increased importance of outsourcing.

It is important to note that the CPSS and IOSCO are currently reviewing the application of their recommendations for CCPs to OTC derivatives clearing. A general review of the full set of recommendations is envisaged thereafter. The ESCB and CESR will review the possible impact of these revisions in order to ensure that the ESCB-CESR recommendations continue to be at least as stringent as the CPSS-IOSCO ones.