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REPORT

on the communication from the Commission to the Council and the European Parliament entitled 'Clearing and settlement in the European Union. Main policy issues and future challenges'
(COM(2002) 257 – C5-0325/2002 – 2002/2169(COS))

Committee on Economic and Monetary Affairs

Rapporteur: Generoso Andria

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PROCEDURAL PAGE

By letter of 28 May 2002 the Commission forwarded to Parliament a communication entitled 'Clearing and settlement in the European Union. Main policy issues and future challenges' (COM(2002) 257 – 2002/2169(COS)).

At the sitting of 2 September 2002 the President of Parliament announced that he had referred the communication to the Committee on Economic and Monetary Affairs as the committee responsible and the Committee on Legal Affairs and the Internal Market for its opinion (C5-0325/2002).

The Committee on Economic and Monetary Affairs had appointed Generoso Andria rapporteur at its meeting of 19 June 2002.

It considered the Commission communication and the draft report at its meetings of 7 October, 4 November, 28 November, and 3 December 2002.

At the last meeting it adopted the motion for a resolution by 22 votes to 8 , with 1 abstention.

The following were present for the vote: Christa Randzio-Plath, chairman; Philippe A.R. Herzog and John Purvis, vice-chairmen; Generoso Andria, rapporteur; Juan José Bayona de Perogordo (for José Manuel García-Margallo y Marfil pursuant to Rule 153(2)), Pervenche Berès, Roberto Felice Bigliardo, Jean-Louis Bourlanges (for Brice Hortefeux), Hans Udo Bullmann, Manuel António dos Santos (for Helena Torres Marques), Jonathan Evans, Robert Goebbels, Lisbeth Grönfeldt Bergman, Catherine Guy-Quint (for Giorgos Katiforis pursuant to Rule 153(2)), Christopher Huhne, Anne Elisabet Jensen (for Karin Riis-Jørgensen pursuant to Rule 153(2)), Othmar Karas, Piia-Noora Kauppi, Werner Langen (for Ingo Friedrich), Alain Lipietz, Astrid Lulling, Thomas Mann (for Hans-Peter Mayer), Ioannis Marinos, Giuseppe Nisticò (for Renato Brunetta pursuant to Rule 153(2)), Fernando Pérez Royo, Jacques F. Poos (for Bernhard Rapkay pursuant to Rule 153(2)), Alexander Radwan, Olle Schmidt, Peter William Skinner, Ieke van den Burg (for Mary Honeyball) and Theresa Villiers.

The Committee on Legal Affairs and the Internal Market decided on 10 September 2002 not to deliver an opinion.

The report was tabled on 4 December 2002.

MOTION FOR A RESOLUTION

European Parliament resolution on the communication from the Commission to the Council and the European Parliament entitled 'Clearing and settlement in the European Union. Main policy issues and future challenges' (COM(2002) 257 – C5-0325/2002 – 2002/2169(COS))

The European Parliament,

– having regard to the Commission Communication (COM(2002) 257 – C5-0325/2002[1]),

– having regard to the Report of November 2001 entitled 'Cross-border clearing and settlement arrangements in the European Union' published by the 'Giovannini Group'[2] which advises the Commission on financial market issues,

– having regard to Rule 47(1) of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs (A5-0431/2002),

A. whereas Directive 98/26/EC on settlement finality in payment and settlement systems[3] marked a key stage in the process of establishing an effective legal framework for payment and securities settlement systems,

B. whereas the Lisbon European Council pointed to the strategic importance of integrating the financial markets by 2005, bearing in mind that they are central to the European growth and employment strategy,

C. whereas the elimination of the exchange risk in the euro area increases the interdependence of the markets at all levels; whereas the United States has made the choice of a unified clearing, settlement and custody framework, which entails a single strategy, a single leadership team and a single technology gateway; notes that the US DTCC clears up to 20 million transactions per day totalling USD 600 billion,

D. whereas the European Commission is currently engaged in consultations with interested parties on a policy on clearing and settlement in the EU,

E. whereas the Giovannini Report[4] identified and listed barriers to efficient cross-border clearing and settlement and stated that urgent action is required to remove the barriers,

F. whereas it is essential to have efficient clearing and settlement arrangements (that is to say, which offer the right services at the right cost and are competitive and safe) for the EU as a whole, since these are intrinsic to the operation of the financial system,

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[1] OJ C ..../Not yet published in OJ.
[2] http://europa.eu.int/comm/economy_finance/publications/giovannini/clearing1101_en.pdf
[3] OJ L 166, 11.6.1998, p. 45.
[4] http://europa.eu.int/comm/economy_finance/publications/giovannini/clearing1101_en.pdf

G. whereas the existing clearing and settlement arrangements within the EU are highly efficient where the processing of securities transactions at domestic level is concerned, they do not combine to enable cross-border transactions to be processed efficiently at the post-trade stage; yet without efficient cross-border clearing and settlement arrangements, the advantages of an internal market in financial services will be impossible to exploit to the full,

H. whereas the inefficiency of cross-border clearing and settlement in the EU is due largely to the fragmentation resulting from national differences in technical requirements and market practice, tax procedures, and legal barriers,

I. whereas to attain a high degree of market efficiency and limit costs, steps will need to be taken to remove technical, market and legal barriers and gradually within long time frames, tax systems,

J. whereas in order to oversee the market, there have to be mutual understanding, a common approach and harmonised rules among supervisory authorities,

K. whereas Directive 93/22/EEC on investment services will be the subject of a revised proposal from the Commission in order to deal with aspects of trading, to which the subjects of clearing and settlement are closely related,

L. whereas clearing and settlement is undertaken by many competing institutions such as CCPs ('central counterparties'), CSDs ('central securities depositories'), ICSDs ('international central securities depositories'), global custodians, local custodians ('local agents'),

M. whereas the market has, in the absence of a dedicated framework, delivered a consolidation of clearing and settlement entities that nevertheless now makes it essential for a proposal for a directive to be drawn up,

N. whereas the 'PRIMA' approach (Place of the Relevant Intermediary Approach) which is currently under discussion in 'The Hague Convention on Indirectly Held Securities' is likely to alleviate the issue of conflicts of laws,

O. whereas competition policy in the EU (Articles 81, 82 and 86 of the Treaty) applies to all undertakings, including clearing and settlement,

P. whereas the ECB (European Central Bank) and CESR (Committee of European Securities Regulators) have commenced joint work in the field of clearing and settlement concerning the possible adaptation to the EU of the CPSS (Committee on Payment and Settlement Systems) / IOSCO (International Organisation of Securities Commissions) 'Recommendations for Securities Settlement Systems'[1], concerning an analysis of central counterparties' clearing activities and concerning a review of the Giovannini Report,

[1] Report of the CPSS-IOSCO Joint Task Force on Securities Settlement Systems.

1. Welcomes the Commission communication, which it regards as a first step required in order to develop a clearing and settlement policy in the EU; considers that the Commission should not confine itself to simple indicative mechanisms, but should instead propose clear rules and regulations that will ensure equality of treatment between different market participants;

2. Considers that this communication amounts only to a first stage, and calls on the European Commission to draw up, in coordination with its work on the Investment Services Directive (ISD), a specific directive concerning clearing on the one hand and settlement on the other and laying down common rules, in particular on authorisation, supervision, freedom of establishment and to provide services, and a common infrastructures framework;

3. Points out that if it is to be competitive on a global scale, the EU financial market has to have the necessary solidity and liquidity and be efficient, safe, transparent, and cost-effective;

4. Believes that if European clearing and settlement systems are too costly to use, or if the infrastructure is insufficient to perform the desired functions, market players might refrain from investing or resort to other potentially riskier ways of finalising cross-border transactions;

5. Notes that the excessive cross-border costs have to be eliminated and the greatest risks, whether legal or of another nature, arising from the inefficiency of clearing and settlement must be minimised in order to bring about a genuinely integrated securities market in the EU; calls on the Commission to study thoroughly the American example and to give a detailed assessment of its strengths and weaknesses to assess whether such an architecture could be set up in Europe;

6. Proposes that the first barriers to break down should be the technical barriers (such as the elimination of differences in information technology systems, adoption of intra-day finality between systems) and a move towards inter-operability of systems;

7. Calls on market participants to work via effective common action to eliminate technical/market barriers, since action by market participants is the most efficient way of removing these barriers;

8. Considers that, in addition to removing technical differences it will be necessary to remove the obstacles to the finalisation of individual cross-border transactions posed by national differences in the legal and tax requirements applying to securities;

9. Proposes that the forthcoming revision of Directive 93/22/EEC should provide for Member States to grant the right of access for investment firms from other Member States to central counterparty, clearing and settlement systems in their territory and that these systems should be subject to the harmonised transparent and objective criteria applicable to local participants; proposes that an information statement be drawn up identifying the fundamental differences between the Member States' laws affecting clearing and settlement systems, in order to guide market participants; considers that in the long-term the creation of a securities code could be envisaged; takes the view, however, that this

should be a long-term policy ambition, since this is not a feasible short-term goal due to the necessity of dealing with differences with regard to the legal framework for sensitive issues such as company law, property rights and insolvency law; proposes that a working party of securities experts should be set up rapidly to study in detail the questions raised by harmonisation of securities law within the EU and to propose solutions to the differences recorded;

10. Maintains that a further aim should be to eliminate distortions of competition or differences in the treatment of entities carrying out similar clearing and settlement activities and that a fully integrated EU-wide clearing and settlement infrastructure presupposes that rights of access to the systems should be comprehensive, transparent, fair and, above all, effective;

11. Proposes an arrangement for 'core' settlement services that should be managed for legal purposes as a user-owned service governed by the rules of non-profit status, after allowing for necessary investment needs, so as to generate fewer costs without distorting competition, given that the agents are at the same time economic mainstays of the structure proper; points out that this formulation will be able to stimulate lower prices, higher quality services and increased innovation, allowing market forces to consolidate the established architecture, with appropriate legislation where there is risk;

12. Proposes that central securities depositories should perform national and cross-border infrastructural securities settlement services and central securities depository services on an exclusive basis, whereas 'value added services' must be provided by means of a shared or supervised structure that should remain separate, also from a logistical point of view; proposes that the risk-exposure of such entities should be limited to the taking of operational risks, to the exclusion of any banking risk, and that they should be organised and supervised so as to ensure that the risk of contagion between the various functions is non-existent; calls for the other services to be supplied in a clearly separated manner and subject to supervision, so as to avoid any distortion of competition;

13. Urges the Commission to rapidly bring its inquiry into competition aspects of clearing and settlement systems to a close, in order to ensure that Community competition policy is respected in this sector with regard to discriminatory pricing, exclusive arrangements and excessive pricing;

14. Considers that there should be enhanced cooperation between supervisors to ensure that there is adequate supervision of clearing and settlement systems, and that supervisors should cooperate on a regular basis, in accordance with a common framework, including rules of admission, supervision and passports for freedom of establishment and to provide services;

15. Welcomes the joint work of the ECB and CESR in the field of clearing and settlement and urges the project to conclude its work as soon as possible, whilst recommending that this initiative and the Giovannini initiative do not duplicate the work of the European Commission on the subject;

16. Considers that the simplest means of eliminating legal barriers to and differences in the

regulation of entities active in the areas of clearing and settlement will consist, in the short term, in drawing up a directive laying down a common framework (authorisation, rules of operation, supervision and cooperation between competent supervisors, passport) for the exercise of clearing and settlement activities and, in the long term, establishing a securities code;

17. Instructs its President to forward this resolution to the Council and Commission and the parliaments of the Member States.

EXPLANATORY STATEMENT

1. Introduction

On 28 May 2002 the European Commission published a Communication entitled *'Clearing and Settlement in the European Union – Main policy issues and future challenges'* [1]. The Commission Communication builds on the first 'Giovannini Report'[2] of November 2001, which identified the sources of inefficiency in cross-border clearing and settlement arrangements in the EU. The Commission Communication highlights the main problems and requests comments as to potential EU policy directions.

Clearing and settlement are the functions by which a securities transaction is finalised:-

i. **Confirmation:** the terms of the trade by the buyer and the seller are established;

ii. **Clearance:** the respective obligations of the buyer and seller are calculated (i.e. who owes what);

iii. **Delivery:** the securities are transferred from the seller to the buyer;

iv. **Payment:** the funds are delivered from the buyer to the seller. Settlement of the transaction is achieved once delivery and payment have been finalised.

Clearing and settlement are an essential component of all (wholesale and retail) securities transactions and are therefore fundamental to the smooth functioning of integrated securities markets (they are often referred to as the 'plumbing' of financial markets). It is essential to manage the potentially high risks of clearing and settlement systems effectively in order to ensure the stability of the financial system.

Despite the increased demand for foreign securities since the introduction of the Euro, the EU's infrastructure for clearing and settlement for cross-border transactions remains fragmented. This fragmented infrastructure means that the costs of cross-border securities transactions are disproportionately high in comparison with national transactions. The Giovannini Report and Commission Communication point to many barriers to efficient cross-border clearing and settlement, creating these high costs and inefficiencies. In order to deal with the fragmentation and high costs, and in order to ensure that risks are managed effectively, a combination of actions is proposed by the Commission:

- **the removal of barriers to the finalisation of individual cross-border transactions:** how to deal with technical/market practice barriers, taxation and legal barriers.

- **the removal of distortions and constraints in EU post-trading environment:** the creation of a level playing field between institutions, developing rights of access and choice and the development of a common regulatory view.

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[1] COM(2002) 257.
[2] http://europa.eu.int/comm/economy_finance/giovannini/clearing_settlement_en.htm

2. Key Issues

There are several key issues which arise as a result of the questions posed by the European Commission in its Communication.

a) USA model

Via regulatory intervention, the USA created the DTCC (Depository Trust and Clearing Corporation), which incorporates both clearing and settlement systems. This structure is in stark contrast to the situation in Europe where, for example, there are as many as 20 CSDs (Central Securities Depositories which carry out settlement functions). Due to the efficiency of the DTCC in delivering cost-effective clearing and settlement, the creation of one infrastructure via regulatory intervention appears to be a tempting proposition. However, this would necessitate a radical sweeping-away of the current structures in Europe, which would be problematic due to the different legal frameworks.

b) A public utility, non-profit structure

'Core' settlement services should be managed as public utility services, the reason being that these services are public interest services. These 'core' services should be provided within special utility entities and there should be a separation of functions between the commercial ('value-added services' services) and the non-commercial functions ('core' services), both legally and logistically. The core settlement services should be managed on a non-profit basis in order to ensure interoperability and transparent/value-for-money fees for users.

c) Creation of competitive level playing field

Key principles to be adhered to should include comprehensive and non-discriminatory rights of access, reasonably priced fees, the prevention of anti-competitive behaviour and the prevention of exploitation of a monopoly situation. It is widely agreed that there should be a removal of factors leading to the creation of distortions or inequalities in the treatment of the same activities. The revision of the Investment Services Directive (ISD) should allow the right to use a CCP/CSD in another Member State.

It is acknowledged by many interested parties that as a general principle, competition in the clearing and settlement market could stimulate lower prices, higher quality services and increased innovation. There has been a general trend of increased competition between the different actors in the clearing and settlement system for the provision of settlement and custodian and 'value-added services' (e.g. securities lending).

d) Possible policy tools

Anti-competitive behaviour could be dealt with by strong enforcement of existing competition policy. For example, many point to the need to examine the trend towards the creation of 'vertical silos' ('exclusive arrangements' where the owners of a competitive trading platform own the CCP/CSD and where there is therefore no choice of post-trade venue).

Effective corporate governance could ensure the public interest of users in terms of access, choice and interoperability, as well as ensuring that the entities are soundly managed, in order to take account of the financial stability of the financial markets. Corporate governance could include, for example, the establishment of panels of users to monitor fees and ensure that promises of no fee increases are implemented. This could compare favourably to the DTCC model, which is equally supervised by its users.

e) Priority for removal of barriers

Several market barriers could be dealt with by co-ordination by market organisations, such as the elimination of differences between information technology systems. Market participants should work together to resolve the technical barriers, since they are the most appropriate institutions to resolve these matters.

Most interested parties view barriers related to national restrictions on the location of clearing and settlement systems and national restrictions on the location of securities as the most harmful of the legal barriers. They could therefore be a priority target of the Commission. Both of these restrictions increase costs for cross-border clearing and settlement and appear to protect national markets. Tax barriers will be a particularly difficult area to resolve, and could therefore not necessarily be dealt with as a priority since it would be difficult to reach agreement by Member States.

f) Securities Code

It is widely acknowledged that the application of the PRIMA approach (Place of the Relevant Intermediary Approach) currently being discussed by the Hague Convention on Indirectly Held Securities, is likely to alleviate the problem of conflicts of laws.

The creation of a single securities code could appear too ambitious a goal in the short term since it would entail an enormous exercise of harmonisation, on which it would be difficult for Member States to reach agreement, since national securities legislation is linked to sensitive issues such as property rights, company law, insolvency law. The creation of a securities code could be a long-term objective, but not one which it is practical to envisage in the short or medium term.

Since the creation of a securities code is a long-term policy goal, in the medium term an information statement could be drawn up which would provide market participants with a guide to the differences between the laws in the Member States.

g) Co-ordination of supervision

Given the potential cross-border consolidation of the clearing and settlement industry, it is important to ensure that there is adequate supervision. Supervisors in the Member States should cooperate between each other on a systematic basis in order to ensure a proper management of risks and to ensure the stability of the financial system.