

ISSA Regional Meeting Europe, 23 May 2003

Update on ESF Activities, Priorities and Concerns

Dr. Werner Frey, CEO, European Securities Forum




First of all I would like to thank ISSA and BNP Paribas, the host of this Regional Meeting Europe, for their much appreciated invitation to the European Securities Forum to present its activities, priorities and concerns.



I will cover the following five points in my presentation, hopefully with some time left to answer questions you might have:

1. When speaking to a then potential – in the meantime real – new member of ESF, my interlocutor in Milan made it clear that his bank would be interested to join always provided that we would kind of re-invent ESF – that coincided with the expectations of many of our existing members; let me therefore describe some principal areas of constancy and of change.
2. The changes in ESF's profile and the changing environment are highly inter-dependent; I shall therefore trace some main elements of a changing environment and ESF's response to it.
3. In the third part I shall outline the work of ESF's Operations Committee in the past five months and the concrete action plan resulting from it.
4. ESF's role as an agent of implementation, as an agent of change in the arena of clearing and settlement in Europe is described in the fourth part before finally drawing some conclusions.

ESF's profile – constancy and change



ESF's profile – constancy and change

- Unchanged key principles
- Change of focus in a changing environment: from the vertical vs horizontal debate to the gruelling work of the Operations Committee
- European, not Anglo-Saxon
- Sole organisation focusing exclusively on the European post-trade part of the value chain

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Our four key principles, our long term objectives are unchanged, that is:

- Firstly, the objective of single integrated *process* in Europe for clearing and settlement.
- Secondly, the requirement that this process will deliver reduction of costs and risk as well as reliability, integrity and scalability.
- Thirdly, a solution that is technologically based on the 'best in class' principle avoiding duplicate developments.
- And fourthly a single clearing and settlement process that will be largely user owned and user governed.

Our strategy and our approach of how to achieve these objectives, however, have changed significantly. Does this mean that the objective of a merger of Euroclear and Clearstream, the debate on high level structural issues such as the vertical vs horizontal integration or the plan to create a single pan-European CCP have all been meaningless?

No, I would argue: merging the fixed-income businesses of Euroclear and Clearstream would make as much economic sense today as it did some three years ago. Debates of a structural nature as well as on the preferred model of ownership and governance will have to be held again as the consolidation of the industry takes further shape. But the environment has changed:

- consolidation processes follow their own logic – and commercial interests – rather than the blueprint of an industry group like ESF;
- the need to reduce risk and cost of cross border securities transactions on the other hand has become even more urgent as market conditions sharply deteriorated;
- the insight grew and is further growing that the highly fragmented and diverse current situation is hardly a fertile soil for a big-bang solution; and: one size does not fit all in Europe;
- the window of opportunities for change – including changes at the legal, fiscal and regulatory front – has opened and needs to be made use of before the awareness created, before the political and commercial will for change will fade away again or, even worse, before political bodies act unilaterally in a way as they did in the area of cross border payments.

Against this background we took the decision with our members to change for a more pragmatic and practical approach to create value for our members – and for the markets – to focus on areas where the combined forces of our members do make a difference compared to them acting individually, in representing the largest market operators vis-à-vis market infrastructure organisations and vis-à-vis public sector bodies, particularly at EU level.

In this context the perception of ESF as an Anglo-Saxon organisation or, even worse, as a representative of American interests in Europe, has not been helpful. Making ESF a truly European organisation is an objective where we have achieved first successes both in terms of expanding the membership in continental Europe and in the Nordic area, in terms of our internal structure and organisation and in terms of changing perception and recognition.

Although our brief is much broader we focus exclusively on the European post-trade part of the value chain to meaningfully contribute to achieve the objective of an integrated, competitive European capital market. Although this exclusive focus makes us unique in Europe, we seek the cooperation with a broad range of institutions and organisations that pursue similar objectives both in the private and public sector. The tasks ahead of us are simply too challenging to allow a different approach.

Responsive to a changing environment

In more concrete terms, how do we define our role to play, to be responsive to a changing environment?



Responsive to a changing environment

- The broad consensus achieved at global and at European level: key condition to success
- ESF's complementary approach
- The objectives of ESF's Operations Committee: defining priorities and specific requirements of market operators
- ESF's role as an agent of implementation

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To start with: there is no need of yet another analysis of the shortcomings of the current clearing and settlement landscape nor another high level action plan to reduce or eliminate these deficiencies. Your organisation from ISSA 4 in 1988 to the ISSA Recommendations 2000, CPSS/IOSCO, the Group of 30 and the Giovannini Group have done a superb job. They have achieved a broad consensus at global and at European level among private sector market participants, political authorities and regulators. They have worked out the basis to build on, without which the risk of being confronted with 'back to square one' would be high time ad again.

Against this background ESF set up the Operations Committee at the end of last year not to duplicate the aforementioned work of ISSA, the Group of 30 or the Giovannini Group but to complement it, to answer – by harnessing senior operations executives of the largest market operators active in the European securities markets – the question: what next, i.e. to support and accelerate the process of implementation, thereby seeking the cooperation with institutions and organisations with similar objectives both in the private and public sector.

The dual objective of the Operations Committee has been set:

- to define the areas of highest priority in harmonising the processes and procedures of cross border clearing and settlement in Europe and based thereon work out specific requirements to be discussed with and/or submitted to securities infrastructure organisations, particularly (I)CSDs and CCPs, and
- to define the most detrimental legal and regulatory hurdles for cross border transactions and based thereon work out a list of priorities of required legal and

regulatory changes at national levels as well as propose the prioritised areas for EU-wide legal harmonisation to be discussed with the EU Commission.

This is a reflection of our role as an agent of implementation contributing the profound knowledge and experience made available by our members and thus our aim to initiate the implementation process and participate in its coordination and monitoring.

The Operations Committee: results

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The Operations Committee: Results

- **The first set of priorities and specific requests**
 - Standardisation and harmonisation of communication
 - Harmonisation of settlement timeframes / operating hours and corporate actions
 - Removal of restrictions of open access and free choice
 - Harmonisation of the legal environment in Europe

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Within a period of some four months ESF's Operations Committee worked out a first set of priorities and specific requests on which all its members agree, irrespective of whether they represent an investment bank, a custodian bank, an agent bank or a universal banking type of organisation, whether its head-office is located in Europe or in North America. The four areas of priorities are:

- The standardisation and harmonisation of communication, such as ISO 15022 as the sole messaging format standard throughout Europe, compatible with global standards.
- The harmonisation of settlement timeframes and operating hours and rules relating to corporate actions, such as the standardisation of record and ex-date for all corporate action events and income payments.
- The removal of restrictions of open access and free choice, such as the elimination of national settlement and depository requirements in Germany or the registration process in Spain.
- The harmonisation of the legal environment in Europe, such as the introduction of an EU wide legal definition of transfer of ownership in dematerialised securities, an area in which we closely cooperate the European Financial Market Lawyer

Group, chaired by senior legal executives of ECB and the Financial Markets Law Committee, domiciled at the Bank of England.

This set of priorities is of a medium term nature in terms of implementation, medium term realistically meaning the next few years.

To increase the dimension of practicability, to answer the question: and what does this mean in reality, ESF's Operations Committee developed furthermore the first of a series of action plans for 2003.



The Operations Committee: Results

- **Action plan # 1 for 2003**
 - Criteria
 - short timeframe
 - priorities markets
 - least disruptive
 - tangible benefits at lowest investment cost

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From a long list of actions those have been chosen that best met the following criteria:

- tangible benefits at lowest investment cost, taking into account the current market environment;
- short timeframe of realisation;
- choosing prioritised markets, i.e. markets of size and importance;
- least disruptive to current processes protecting investments made.

Eight very detailed and specific actions to be completed by the end of 2003 are the result all to be tackled simultaneously:

The Operations Committee: Results

- 8 very specific actions to be tackled simultaneously
 - BIC in France and Switzerland
 - UK 15022 for securities financing in the UK
 - First step towards standardisation of corporate action events
 - Standardisation of settlement timeframes and operating hours
 - Automation of tax reclaim in Italy and Switzerland
 - Elimination of registration process in Spain
 - First step towards legal harmonisation across Europe
 - Home country passport principle for regulation

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- Reach agreement with Euroclear France and SIS to eliminate the currently required local identification codes for counterparties in France and Switzerland as a first step towards the standardisation of instrument / counterparty / client identification in all European infrastructure systems enabling referencing within market users systems. First discussions with SIS show that we apparently smash open doors.
- Reach agreement with Crest to introduce ISO 15022 standard for each of securities lending and repo transactions in the UK market as a step towards the objective of using ISO 15022 as standard in securities financing transactions.
- Create an expert group, including representatives from regulatory authorities, to work out a model to be implemented in all European markets as a basis for the standardisation of record and ex-date for all corporate action events and income payments.
- Reach agreement with ECSDA on standardisation of settlement timeframes and operating hours. Our discussions with Giovanni Sabatini, the Chairman of ECSDA show a coincidence of priorities: ECSDA's Working Group 5 has exactly this mission as a first priority in terms of analysis, options and proposal to be concluded by the end of this year.
- Reach agreement with the Italian and the Swiss tax authorities to allow automation of cross border tax reclaim process as a first step towards the standardisation of rules and procedures for tax process.
- Reach agreement in principle with the Spanish authorities and with Iberclear to eliminate the registration process.
- Reach agreement with the EU Commission to establish an expert group with an agreed brief with a view of a single EU-wide legal definition of ownership and transfer of ownership in dematerialised securities.

- Reach agreement of principle with relevant political and regulatory authorities to reach acceptance of the regulatory home country passport principle within the EU for custody and investment administration.

You will have noticed our optimisation approach, i.e. to avoid getting lost in details on the one hand by imbedding detailed actions in the realm of overriding objectives and to avoid the risk of being too generic and high level to be of practical use on the other hand.

The way forward: implementation



The way forward: implementation

- Encouraging response to ESF's Call for Action
- Rallying the support of organisations with similar objectives
- Set the stage for cooperation and coordination
- The interdependence of influence and representation – ESF's role as a recognised "messenger" between the market and EU public sector bodies

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The positive responses to our 'Call for Action' way beyond the constituencies of our membership and the institutions directly involved or addressed – including also some rather unexpected positive media reactions – encourage us to pursue our approach and to take the detailed plans at hand immediately to make actions plan # 1 reality by the end of this year and to start the work on subsequent actions plans in the near future.


I mentioned it earlier: in the absence of a European version of SIA we are thereby seeking the support and the cooperation of organisations that pursue similar objectives at global or at European level, such as for example the Association of Global Custodians or the ESI Working Group of the European Banking Federation.

Chris Tupker, the Chairman of Euroclear proposed that ESF should take the lead in the process providing for interoperability in Europe – Bob Douglas, the Chairman of Clearstream is sympathetic to the idea. At the same time the Giovannini Report II proposes to create a body to coordinate and monitor the process to remove the defined barriers to an integrated European clearing and settlement. We see our role in representing the market in this body along with representatives of the EU Commission, ECB, ECSDA and CESR.

To be able to exert the influence the largest market participants deserve to exert, not least because they will pay, directly and indirectly, for the bulk of the investment cost associated with the integration process, a broad representation of all relevant European markets in ESF is important. Likewise, ESF's role as a recognised messenger between the market and EU public sector bodies will increase the attractiveness to be one of its members. Or, as Richard Greensted commented on our action plan:

"There is a huge gap to be bridged between the high-minded principles of Giovannini and the considerably tougher task of fixing the plumbing. ESF looks well placed to mind the gap."

To conclude:



Conclusions

- The urgent need to start the implementation process and to build momentum
- The case for cooperation with the public sector and among private sector organisations
- Europe as ESF's centre of gravity – compliant with global standards
- ESF: an agent of implementation representing the market

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- The implementation process needs to start now as a matter of credibility of the private and the public sector.
- Cooperation will be the recipe for success – cooperation between the public and the private sector but also cooperation among private sector organisations.
- Europe is ESF's centre of gravity, however, always with a view to be compliant with global standards.
- And last but not least, as you may have noticed: ESF has changed to be an agent of implementation representing the market.

Thank you.