

# ISSA Regional Meeting Madrid

May 22-23, 2003

Hosted and chaired by BNP Paribas Securities Services

## 1. Opening Remarks

Mr Jacques-Philippe Marson, President & CEO of BNP Paribas Securities Services, acting as host and Chairman of the Day, welcomed around 70 delegates comprised of ISSA members and guests. 25 countries were represented. The meeting addressed two main topics: the positioning of the ICSDs, CSDs and custodian agent banks in a converging European capital market infrastructure on one hand, and the impact of the recently issued G30 recommendations on ISSA and its members.

## 2. ISSA Information Items

The full text and the slides used in Mr Landolt's presentation are available separately. Main points included:

- ISSA's participation in the 5<sup>th</sup> General Assembly of the Americas' Central Securities Depositories Association (ACSDA) in Cancun in March 2003. ISSA's contribution was threefold:
  - An initial assessment of the G30 recommendations and ISSA's plans for dealing with them.
  - An update on the current restructuring of the European capital market infrastructures following the introduction of the euro.
  - A review of local, regional or global industry initiatives in the area of corporate actions and reference data standardisation, highlighting the multitude of parallel efforts and the need for coordination.
- ISSA's positioning towards the G30 recommendations released in January 2003. Based on an analysis of overlaps and gaps between the ISSA Recommendations 2000 and G30, ISSA has offered to the Group of Thirty to take monitoring responsibility for some of the G30 recommendations. At the same time, ISSA is willing to suspend monitoring activity on those ISSA Recommendations which are sufficiently reflected in equivalent G30 recommendations. ISSA's proposal is preliminary, as it is subject to discussion with other industry bodies that may become involved in the process, and with the G30 Monitoring Committee itself.
- Over the coming months, the ISSA board will review ISSA's general direction and priorities for the next few years. In view of a possible close and long-term involvement with the Group of Thirty monitoring process, the moment is right for a comprehensive analysis of questions relating to the allocation of resources, possible cooperation models with other organisations, and alternatives to increase the efficiency in existing processes within ISSA.

### **3. Panel and Floor Discussion: European Market Infrastructure / Agent Banks vs ICSDs**

Panelists:

- Marinus Maaskant, Managing Partner, tracktion BV (Moderator)
- Yannic Weber, Managing Director, Euroclear Bank
- Volker Potthoff, Managing Director, Clearstream International
- Fritz Klein, Member of the Executive Board, SIS Group
- Charles Cock, Head of Multi-Direct Clearing & Custody, BNP Paribas Securities Services
- William Higgins, Managing Director, ABN AMRO Bank

In order to launch the floor discussion, the panelists were asked to give their views on the development of the pan-European clearing and custody universe over the next five years, with emphasis on the perceived roles of the ICSDs and the agent banks.

#### **The Agent Banks' View as Core Infrastructure Users:**

- Europe's cash market products are more tightly linked to the derivative markets than is the case in the USA; cash and derivative markets are more and more converging. Europe should therefore not necessarily follow the US infrastructure model.
- Trade netting and the emergence of CCPs for the cash markets is a new factor and a fundamental move for Europe. It will determine much of Europe's course over the next few years.
- Eventually, the pan-European market may converge around a small number dominating exchanges and perhaps two leading CCPs.
- Internationally active market users prefer horizontally organised infrastructures over vertical, silo-type ones. Market users want free and unbundled choice of service components along the entire value chain.
- The ICSDs have become banks and thus competitors to the subcustodians. As such, they should not be allowed to control CSDs. Just as airport authorities do not run airlines, core market infrastructure platforms should not at the same time run the same business as their users do.
- Core infrastructures have a special role in taking the G30 and the Giovannini Recommendations to implementation.
- Avoid cross-subsidisation and cross-ownership between components of central market infrastructure.

### **The ICSDs' View as Operators of Core Infrastructure:**

- The European and the US market are not comparable. The existing fragmentation in Europe in many areas rules out a "European DTCC" in the near and medium-term future.
- Cross-border transactions in Europe are still too expensive. Full and free competition should be encouraged. It seems odd that the banking sector, by tradition and by nature one of the most "capitalistic", is calling for more regulatory intervention in the financial services industry.
- Don't destroy a company on suspicion: There is a tendency today to call for antitrust law to be invoked when companies are merely suspected of cross-subsidisation, or if they have a dominant position in a market. Overheated reactions should be avoided. "Just because I have got hands does not mean that I am a thief!"
- As long as there is fragmentation, standardisation and interoperability are key. A single "Securities Settlement Engine" across markets will enhance processing efficiency, hence decrease cost to the market users. A single account at ICSD level - for those market users who want it - is an important step towards a more efficient environment.
- Legal, regulatory and fiscal issues are problems that can only be dealt with by taking a pragmatic approach. Small steps need to be taken, one at a time, to achieve tangible progress.
- In all areas of service provision, certain business segments will become utility services over time and may become the subject of consolidation.
- CCPs are an element of value added service which will gain relevance in the future.
- The market wants – and has a right to – receive unbundled service offerings and total transparency.
- Volume discounts granted to large users should be limited, as they are also a means to distort the principle of equal access to system users.
- Ensure that internal transfer prices are the same as external prices.
- Market infrastructures owned by investors will always be forced to be efficient. The ownership debate is rather overheated!

The subsequent floor discussion sought to elaborate on remarks made in the opening sequence. Some excerpts follow below:

### **Will Agent Banks Still Exist in Five Years' Time?**

- They will exist but must constantly adapt to a changing environment, or they will go the way of the dinosaurs! As the infrastructure consolidates, agent banks will have to find new roles to justify their intermediation.
- Local custodians will increasingly compete for intra-European business through private labelling. They will retain their role as subcustodians to non-European global custodians.

## Cross-subsidisation

- The Fair & Clear Group's main concern is cross-subsidisation between the ICSDs and the CSDs controlled by them. However, the industry should acknowledge that the ICSDs are investing heavily in areas that are not yet profitable, but where progress, once achieved, will be good for the industry as a whole. The Mutual Funds area is a case in point.
- "Achieving synergies" is a nice word with which the ICSDs like to justify cross-subsidisation. The question is: on whose side do the synergies really materialise?
- Investors cannot stand cross-subsidisation. With regard to Clearstream for instance, there is none between Clearstream Luxembourg and Clearstream Frankfurt. The Deutsche Börse Group has a system of strictly segmented financial reporting in place.

## ICSDs Offering Banking Services

- From the ICSDs' perspective, commercial banking services are indispensable. They offer a lot of convenience and added value in a cross-border environment. There are always intra-day credit needs if a market participant wants to do cross-border DVP. Surely, free of payment settlement for all cross-border trades cannot be an option. Banking services are also required for efficient entitlements processing. However, the ICSDs will always be limited purpose banks. Where an ICSD offers local services through a CSD under its control, banking services will either not be offered for CSD services, or users will be free to settle the cash leg of a trade directly at the central bank.
- The agent banks were not convinced of the need to offer banking services in ICSD business. The case of CrestCo was cited as a CSD operating in multiple jurisdictions and currencies ("ICSD-like"), doing so without offering commercial banking functions. The main issue is to synchronise the cash part and the securities part in each settlement so that no money is left idle at all times. Today's processes are such that there is often money "left on the table" even if the ICSDs offer banking facilities.
- The agent banks also argued that the ICSDs are banks with a relatively modest capital base. There was concern that a vast proportion of European settlement activity conducted through the ICSDs would unduly concentrate risk in a very small number of places.

## Institutional vs Functional Regulatory Approach

All statements made supported the view that regulating institutions is no longer workable. The market's core institutions, particularly in Europe, are in a process of rapid transformation and evolution. Therefore, certain business functions should be defined and *these* should be subject to regulation, rather than the institutions performing them. This has increased relevance in a cross-border environment lacking harmonised regulation: One and the same institution may for instance be considered a bank in one jurisdiction and a broker in another, with potentially large consequences on regulatory requirements.

#### **4. Update on the European Securities Forum: Activities, Priorities, Concerns**

The full text and the slides used in Dr Frey's speech are available separately. Main points included:

- The key principles of the ESF remain unchanged but strategy and approach to achieve its objectives have undergone a transformation.
- Areas of priority, specific requests and a first action plan for 2003, established by the ESF Operations Committee. The ESF wants to complement, not duplicate or compete with existing efforts to enhance market efficiency.
- The way forward - implementing the action plan. Elements include ESF's role as a messenger between the markets and EU public sector bodies, but also as a promoter of cooperation among private sector organisations. All changes the ESF envisages are aimed at achieving interoperability in Europe but must be compliant with global standards at the same time.

#### **5. G30 and the ISSA Recommendations 2000 - Introduction to the Group Discussion Session**

The full text and the slides used by Mr Stähli are available separately.

The presentation reviewed the main features and aims of the G30 recommendations, and related activity or calls for action recently launched by European bodies (Giovannini II Report, European Securities Forum). It highlighted the overlaps and gaps between G30 and the ISSA Recommendations 2000, and the resulting preliminary conclusions for ISSA. The meeting participants were then invited to discuss in groups the relevance of the G30 recommendations to their firms or markets, identify their priorities, and offer their views as to what organisations are best suited to undertake appropriate action steps.

#### **6. Working Group Presentations**

Note: The composition of the three discussion groups was approximately equal in terms of geographic and provider type representation. Group 1 was asked to discuss recommendations 1-8 ("creating a strengthened, interoperable network"), Group 2 covered recommendations 9-16 ("mitigating risk"), and Group 3 addressed recommendations 17-20 ("improving governance").

##### **Group 1**

The participants in Group 1 identified (from the range allocated to the group) the three highest priority recommendations, either for their domestic market, or for their firm's business needs. The quick poll yielded a very clear result: The key recommendations are No. 8 (in particular as regards corporate actions processing) followed by No. 3 and No. 2. Recommendation 5 was next at a long distance, and only single or no votes were cast for the remaining ones.

The group also felt that G30 omitted coverage of a particularly cumbersome subject: cross border mutual funds processing.

Some statements made in the group discussion, related to Recommendation 8:

- Given the current state of market infrastructure development in most markets, standardisation of corporate actions is the area that would yield the greatest efficiency gains to market participants.
- The problems with (voluntary) corporate actions are well known and well documented. The industry could give guidance to regulators on how corporate actions should be structured and communicated so as to enable more efficient processing.
- The market practitioners should do more to make their needs known to the corporate lawyers designing many corporate actions.
- Custodians must acknowledge, however, that (voluntary) corporate actions are not designed to fit into the industry's established securities settlement process. Their purpose is to motivate shareholders to undertake certain action that is beneficial to the issuer.
- In the area of corporate actions, the functionality provided by ISO 15022 is not yet exploited to the fullest.

The group also discussed which organisations would be best suited to drive progress on the three priority recommendations. The following were named:

#### Recommendation 8:

- ISSA, the SWIFT-sponsored Securities Market Practice Groups and the European Banking Federation for corporate action issues;
- The Association of Global Custodians (AGC) in cooperation with their local agent banks for issues dealing with the harmonisation of tax documentation. In Europe, the Institutional Fund Managers Association (IFMA) was considered as well-positioned.

#### Recommendation 3:

- ANNA (Association of National Numbering Agencies) as the only non-commercial organisation
- RDUG (Reference Data User Group)
- REDAC (Reference Data Coalition)

A remark was made that some of the data standards used in the industry are proprietary and are owned by commercial organisations. It is virtually impossible to convince such organisations to give up a standard without financial compensation.

#### Recommendation 2:

SWIFT and the Securities Market Practice Groups to ensure adherence to ISO 15022 to the greatest extent possible. It was noted, however, that thousands of

brokers and fund managers worldwide are not using SWIFT and will continue to communicate with custodians via fax, telex, or whatever means that are not conducive to straight-through processing.

## **Group 2**

Group 2 assessed the recommendations addressing risk mitigation. Key points made:

- On due diligence (Recommendations 9 and 10): There are many different concepts to conduct due diligence. Service providers are constantly burdened with questionnaires. Ideally, one standardised questionnaire should be developed and gain international recognition.
- On finality (Recommendation 11): There are many interpretations of finality. In domestic business this is not much of an issue but it is of high relevance in cross-border transactions. For instance, when is finality achieved in a mutual funds settlement?
- On business continuity (Recommendations 12 and 13): Since September 11 a lot of attention has been paid to disaster recovery and business continuity. Innumerable questionnaires have been completed. The real issue, however, is to ensure that the procedures set up in theory are actually tested and can be carried out in practice. It is important that the whole transaction processing chain is involved, including the clients.
- On legal certainty (Recommendations 14 - 16): Legal certainty in a cross-border context is of high concern. However, the private sector will not see much progress until the Hague Convention is adopted at least by all major market jurisdictions.

## **Group 3**

Group 3 established an order of relevance/priority for the recommendations dealing with governance issues. The discussion yielded the following result: No. 19, No. 20, No. 18. Recommendation 17 was considered as given and not to be elaborated on. Key statements presented to the audience included:

- On access to central market infrastructure (Recommendation 18): The emphasis must be on "fair". Exclusion based on national borders is no longer a valid criteria. The example of the Swiss National Bank was noted which has granted direct access to around a dozen foreign institutions. Credit risk is the major concern, some minimum standards should be binding globally. In a world of cross-border links between capital market infrastructures, systemic risk needs ring-fencing.
- On consistent regulation and oversight (Recommendation 20): If regulation is not consistent, there will always be service providers seeking out "regulatory arbitrage opportunities".
- A suggestion was made that service providers - irrespective of type - commanding more than 5% of market share in their respective business should be subject to tightened regulation and oversight.
- It was also suggested that ISSA take a monitoring role for Recommendation 20.

## **7. Concluding Remarks**

The results of the group discussions will be communicated to the Group of Thirty. Additional input will be sought from the Asia-Pacific membership on the occasion of the Regional Meeting in Singapore in October. In view of limited industry resources, work on the G30 recommendations will have to be prioritised. ISSA's input may help the G30 in determining their intended course of action. Further steps on ISSA's side will have to be decided after discussions with the G30 Monitoring Committee have taken place.

Prioritisation of monitoring and compliance efforts must also take place - particularly in Europe - between the different sets of recommendations issued by G30, ISSA, ESF, the Giovannini Group and others.

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