

18 December 2008

CEBS's response to the ECOFIN's request on custodian banks

Executive summary

1. On 3 June 2008 the Council of the European Union requested CEBS to review, in cooperation with CESR, whether risks borne by custodian banks were covered by regulations at least equivalent to the ESCB-CESR draft Recommendations for Securities Settlement Systems and for Central Counterparties in the EU, so as to ensure a level playing field while avoiding inconsistencies in treatment and double regulation.
2. CEBS addressed this request by mapping the draft Recommendations against relevant banking regulations and Level 3 guidance applicable to custodian banks that are credit institutions as defined in the Capital Requirements Directive. In general, this was a very challenging exercise since it compared a set of non-binding and wide-ranging recommendations with a set of binding EU Directives that have a specific focus.
3. An informal meeting with representatives from a number of European custodian banks was organised to allow CEBS to get a better understanding of their practices.
4. In its review CEBS has distinguished between i) custodian banks that act simply as intermediaries in the clearing and settlement systems providing custody services, and ii) custodian banks that also perform activities similar to those performed by Central Securities Depositories/International Central Securities Depositories (CSDs/ICSDs) and Central Counterparties (CCPs).
5. From its analysis CEBS concluded that the draft recommendations relevant to custodian banks that simply act as participants in the system are generally covered in the Capital Requirements Directive and/or other banking regulations.
6. On the other hand, CEBS found that the draft recommendations that relate to the design of the clearing and settlement system, and which are relevant to custodian banks which perform similar activities to CSDs/ICSDs/CCPs, are not met or only partially/indirectly met by banking regulation.
7. However, in the roundtable with custodian banks CEBS was told that settlement operations only form a negligible part of their day-to-day business or were not performed at all. For that reason, CEBS suggests that further work

should be carried out to establish how material the internalisation of settlement is across the European custody banking industry.

8. Regarding clearing services, CEBS was unsure whether in practice any custodian banks actually internalised Central Counterparty activity. Whilst there are similarities, notably with regards to the risk profile, between General Clearing Members (GCMs) and CCPs, in light of the fact that not all GCMs are custodian banks, CEBS felt that to consider their activities was out of the scope of the EcoFin mandate. Going forward, CEBS will consider whether to assess the risks within the GCM community.
9. Depending on the outcome of the materiality assessment, further steps could be considered to address the gaps in the legislation and ensure a level playing field between the relevant parties.

Background

10. At its 3 June 2008 meeting the Council of the European Union ('the Council') formally invited the ESCB and CESR to complete the former draft "Standards for Securities Clearing and Settlement in the EU", based on the following principles:

- (i) the adopted text should take the form of non-binding recommendations solely addressed to public authorities;
- (ii) its scope should include International Central Securities Depositories (ICSDs)¹, and exclude custodians; and
- (iii) on credit and liquidity risk controls, the text to be adopted should replace former draft standard 9 with recommendation 9 of the CPSS-IOSCO Recommendations for securities settlement systems of 2001.

11. The exclusion of custodians from the scope of the ESCB/CESR recommendations was made on the assumption that all relevant risks incurred by custodians are sufficiently addressed under the Capital Requirements Directive (the 'CRD') or other relevant banking regulation. In this context CEBS was invited by the Council *"to further review, in cooperation with CESR, the coverage of risks borne by custodians, taking into account that some CSDs/ICSDs/CCPs are also subject to the CRD, so as to ensure a level playing field while avoiding inconsistencies in the treatment of custodians and double regulation by end 2008."*²

Methodology

Scope and focus of the analysis

12. In light of the Council's request CEBS has focused its work on the custodian banks that are credit institutions, i.e. in accordance with the CRD's definition of credit institution and therefore take deposits as part of their regular activity. Central Securities Depositories (CSDs)³ or Central Counterparties (CCPs)⁴ to which the CRD also applies as a result of a Member State's

¹ A central securities depository (CSD) which was originally set up to settle Eurobonds trades and which is now also active in the settlement of internationally traded securities from various domestic markets, typically across currency areas.

² Council Conclusions on clearing and settlement from 3 June 2008 are published under: http://www.eu2008.si/en/News_and_Documents/Council_Conclusions/June/0206_ECOFIN.pdf

³ An entity that: 1) enables securities transactions to be processed and settled by book entry and; 2) plays an active role in ensuring the integrity of securities issues. Securities can be held in a physical (but immobilised) or dematerialised form (i.e. so that they exist only as electronic records).

⁴ An entity that interposes itself between the counterparties to the contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer.

decision⁵ are outside the scope of CEBS's review because they would be subject to the ESCB-CESR recommendations.

13. To conduct its review CEBS distinguished between i) custodian banks that act simply as intermediaries in the clearing and settlement systems providing custody services and ii) custodian banks that also perform activities similar to those performed by CSDs/ICSDs and CCPs⁶. While custody services are explicitly mentioned in the CRD's list of activities subject to mutual recognition, settlement activity itself is not on this list. Although from a prudential point of view the risks stemming from this activity are also covered by the CRD.
14. CEBS's objective is to assess whether the risks borne by the custodian banks - as defined above - are addressed and fully covered by legal provisions that are deemed equivalent to the ESCB-CESR draft Recommendations and therefore provide the same degree of safety.
15. CEBS has mainly focused its analysis on the CRD. As a basis of comparison, the most basic approaches under the CRD were used. In addition, it has considered other EU Directives and Level 3 guidance applicable to credit institutions and therefore to custodian banks.
16. CEBS has also reflected on other potentially relevant on-going initiatives in the prudential framework, in particular the proposed CRD amendments and the work on liquidity risk conducted by the Basel Committee on Banking Supervision (BCBS) and CEBS.

Informal meeting with custodian banks

17. CEBS organised a half day informal meeting with a number of European custodian banks to get a better understanding of their actual practices. At the meeting participants highlighted that whilst internalisation of settlement does take place, no concrete data regarding the volume or frequency of internal settlement transactions is gathered regularly. Most participants were of the opinion that internalisation is in practice a negligible part of the business.
18. Participants also felt that there were adequate regulations in place and that a level-playing field assessment should be carried out the other way around (i.e. whether the risks borne by CSDs providing custody services are adequately covered).

'Mapping' exercise

19. CEBS has started its analysis by identifying the ESCB-CESR draft recommendations - Recommendations for Securities Settlement Systems

⁵ The CRD only obliges the Member States to apply the Directive to institutions which take deposits, although the Member States can choose (and indeed many of them do) to extend the scope of the CRD to other financial institutions that do not take deposits.

⁶ CEBS has not considered the custodian bank activity related to the business conducted as own account dealers.

(**RSSS**) and Recommendations for Central Counterparties (**RCCP**)⁷ - that can be considered relevant to custodian banks, distinguishing, where appropriate, between internalisers⁸ and participants in the systems. CEBS has subsequently 'mapped' the draft Recommendations and the CRD and other relevant EU Directives and Level 3 guidance.

20. In general, CEBS found the 'mapping' exercise very challenging since it compared a set of non-binding and wide-ranging recommendations with a set of binding EU Directives that have a specific focus. The objectives of the recommendations are manifold covering prudential aspects (financial soundness of the CSDs/CCPs), conduct of business (protection of clearing and settlement customers), efficiency and market integration, and market disruption derived from settlement failures. In contrast, the Directives that apply to custodian banks focus on each aspect individually. The CRD focuses on prudential issues, whilst the MiFID is mainly about conduct of business.

21. In developing its analysis CEBS kept in mind that prudential regulation and the relevant Level 3 guidance primarily aim to limit the insolvency risk of credit institutions/investment firms and not to limit post-trading disruption. CEBS is of the opinion that it would be unrealistic to expect the CRD or other banking regulation to include provisions equivalent to some of the issues addressed in the draft Recommendations (e.g. is not obvious that the CRD should explicitly encourage securities lending/borrowing).

22. The outcome of the 'mapping' exercise, presented in detail in the Annex, was a classification into the following categories:

- i. **'Recommendation met:'** when the draft Recommendation is met and key issues are covered in the applicable EU Directives and/or Level 3 guidance;
- ii. **'Recommendation partially met:'** when the draft Recommendation is generally met, but one or more of the relevant key issues is not covered in the applicable EU Directives and/or Level 3 guidance;
- iii. **'Recommendation indirectly met:'** when the draft Recommendation and the key issues are considered to be met, although the applicable EU Directives and/or Level 3 guidance include no equivalent provisions, but only general provisions or incentives that should ensure the same outcome; or
- iv. **'Recommendation not met':** when the draft Recommendation and all (or most) of the key issues are not covered in the applicable EU Directives and/or Level 3 guidance.

Coordination with ESCB-CESR group

⁷ CEBS has considered in its work the updated draft Recommendations published for public consultation on 23 October 2008 by the ESCB-CESR plenary group: http://www.cesr-eu.org/index.php?page=consultation_details&id=124.

⁸ The notion of « internaliser » refers to a broader notion than the one used in the MiFID. It refers to custodian banks performing a similar activities - and thereby running similar risks - to CSDs/ICSDs and CCPs.

23.To ensure cooperation and coordination with the ESCB-CESR group, representatives from both CESR and the ECB participated in CEBS's work. The ESCB-CESR plenary group received updates on the state and outcome of the work.

Summary of findings from the 'mapping'

24. The outcome of the 'mapping' exercise is summarised in the tables below and is presented in detailed in the Annex.

Draft recommendations for Securities Settlement Systems

ESBC-CESR draft recommendation	Relevance to custodian banks	Outcome of the mapping
RSSS 1: Legal Framework	Relevant only to custodian banks internalising settlement	Recommendation partially met
RSSS 2: Trade Confirmation and Settlement Matching	Relevant only to custodian banks internalising settlement	Recommendation partially met
RSSS 3: Settlement Cycles and Operating Times	Not relevant	-
RSSS 4: Central Counterparties (CCPs)	Not relevant	-
RSSS 5: Securities Lending	Relevant to all custodian banks	Recommendation met
RSSS 6: Central Securities Depositories (CSDs)	Relevant to all custodian banks	Recommendation met
RSSS 7: Delivery versus Payment (DVP)	Relevant only to custodian banks internalising settlement	Recommendation indirectly met
RSSS 8: Timing of Settlement Finality	Relevant only to custodian banks internalising settlement	Recommendation not met
RSSS 9: CSD Risk Controls to address Participants' Failures to Settle	Relevant to all custodian banks	Recommendation met
RSSS 10: Cash Settlement Assets	Relevant only to custodian banks internalising settlement	Recommendation indirectly met
RSSS 11: Operational Risk	Relevant to all custodian banks	Recommendation met
RSSS 12: Protection of Customers' Securities	Relevant to all custodian banks	Recommendation met

RSSS 13: Governance	Relevant to all custodian banks	Recommendation met
RSSS 14: Access	Not relevant	-
RSSS 15: Efficiency	Not relevant	-
RSSS 16: Communication Procedures, Messaging Standards and Straight-Through Processing (STP)	Relevant to all custodian banks	Recommendation indirectly met
RSSS 17: Transparency	Relevant to all custodian banks	Recommendation met
RSSS 18: Regulation, Supervision and Oversight	Relevant to all custodian banks	Recommendation met
RSSS 19: Risks in Cross-System Links or Interoperable Systems	Not relevant	-

Draft recommendations for Central Counterparties

ESBC-CESR draft recommendation	Relevance to custodian banks undertaking CCP-like activities	Outcome of the mapping
RCCP 1: Legal Risk	Relevant only to custodian banks undertaking CCP-like activities	Recommendation partially met
RCCP 2: Participation Requirements	Relevant to all custodian banks	Recommendation indirectly met
RCCP 3: Measurement and Management of Credit Exposures	Relevant only to custodian banks undertaking CCP-like activities	Recommendation indirectly met
RCCP 4: Margin Requirements	Relevant only to custodian banks undertaking CCP-like activities	Recommendation indirectly met
RCCP 5: Other Risk Controls	Relevant to all custodian banks	Recommendation met.
RCCP 6: Default Procedures	Relevant to all custodian banks	Recommendation indirectly met
RCCP 7: Custody and Investment Risks	Relevant to all custodian banks	Recommendation met
RCCP 8: Operational Risk	Relevant to all custodian	Recommendation met

	banks	
RCCP 9: Money Settlements	Relevant to all custodian banks	Recommendation partially met
RCCP 10: Physical Deliveries	Relevant only to custodian banks undertaking CCP-like activities	Recommendation not met
RCCP 11: Risks in Links between CCPs	Relevant only to custodian banks undertaking CCP-like activities	Recommendation met
RCCP 12: Efficiency	Not relevant	-
RCCP 13: Governance	Relevant to all custodian banks	Recommendation met
RCCP 14: Transparency	Relevant to all custodian banks	Recommendation met
RCCP 15: Regulation, Supervision and Oversight	Relevant to all custodian banks	Recommendation met

Main conclusions

25. In general the draft Recommendations that relate to efficiency and market integration were considered not to be relevant for this exercise given the risk emphasis and the remit of CEBS.
26. The RSSS relevant to all custodian banks have been found to be mostly covered by the CRD and/or other provisions (the MiFID for example). The only notable exception is RSSS 16 regarding communication procedures, messaging standards and Straight-Through Processing where CEBS concluded that the recommendation was indirectly met.
27. Regarding the RSSS relevant only to custodian banks internalising settlement rather than using a CSD to perform such functions, CEBS came to a different conclusion. It became obvious during the exercise that the CRD was not drawn up with custodian banks that operated such functions in mind. CEBS thus found that a number of Recommendations, most notably RSSS 2 and RSSS 8, were not or only partially met. However, in the informal roundtable with custodian banks CEBS was told that these operations only form a negligible part of their day-to-day business. Some participants said that they did not perform such operations at all.
28. CEBS found that, similar to the RSSS, those custodian banks participating in the system largely meet the relevant RCCP through CRD and/or other relevant banking regulations.
29. For those custodian banks that perform CCP-like activity, CEBS also found gaps (in particular RCCP 1 and RCCP 10). However, CEBS was unsure whether

in practice any bank actually carried out such activity other than in their function as GCM.

30. In general, CEBS believes that there are certain aspects of the regulatory framework that could be reinforced to more directly address issues relevant to custodian banks (i.e. intraday liquidity risk, operational risk and legal risk linked with this activity) in order to fully address relevant post trading risks for these banks.
31. CEBS also believes that on-going initiatives in the prudential framework, in particular the forthcoming CRD amendments will be likely to address some of the shortcomings identified in the mapping and also the recent work on liquidity risk conducted by the BCBS and CEBS could contribute to address some of the gaps. However this will ultimately depend on the implementation of these initiatives.
32. Going forward, CEBS proposes to investigate in greater depth the significance of custodian banks internalising settlement. CEBS also wishes to clarify whether there are any banks that internalise the CCP function other than in their capacity as GCM. In a further step, following the materiality assessment, CEBS may investigate the risks posed by those banks acting as GCM.
33. As a further step beyond the above, if materiality is established, the proposal would be for CEBS, according with the direction provided by the Council, to investigate how to ensure a level playing field and fill existing gaps in the legislation. In doing so, overlaps with other on-going initiatives should be avoided and synergies fully exploited. Particularly relevant is the recent BSC-PSSC initiative to set up a Joint Task Force on Correspondent and Custodian banking with the aim of developing a common foundation for the analysis and evaluation of risk in these banks. It is envisaged that this Task Force will start its work with an analysis of corresponding banking. On the basis of this experience, expansion of the work to custodian banks will be evaluated. One of the special focus areas suggested is the risks associated with flows that take place outside payment and settlement systems, which includes internalisation of settlement.
34. If the materiality is not established the proposal would be for CEBS to revisit this issue in two years time, because the outcome of the assessment might change in the future if market practices change.

Annex

Detailed 'mapping' of the draft recommendations and the CRD (and other relevant EU Directives and Level 3 guidance)

Mapping the ESCB-CESR draft Recommendations for Securities Settlement Systems (RSSS)

ESCB-CESR RSSS 1: Legal Framework	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>Securities settlement systems, links between them or interoperable systems should have a well-founded, clear and transparent legal basis for their operations in the relevant jurisdictions.</i></p>	<p>Relevant only to custodian bank internalising settlement</p> <p>The recommendation mainly refers to the design of the system in order to offer the maximum protection and transparency for the users. It is therefore relevant to the custodian banks that perform internal settlement as they should ensure similar guarantees and information for their clients/participants.</p>	<p>The CRD harmonises all banking activities under a European framework from a prudential point of view.</p> <p>While custody services are explicitly mentioned in the CRD's list of activities subject to mutual recognition, settlement activity itself is not on this list. Although from a prudential point of view the risks stemming from this activity are covered by the CRD, as is any other activity performed by the bank.</p> <p>However, regarding the legal certainty of settlement operations there are other sets of regulation that are more directly relevant (e.g. insolvency laws) than the CRD. The CRD focuses on the soundness of the banks and</p>	<p>Recommendation partially met</p> <p>Given that banking activities (including those related to post-trading) are covered from a prudential point of view by the CRD, the recommendation could be considered met given the similar legal certainty provided and the necessity for transparency towards the users.</p> <p>However, specifically with regards to settlement finality (see key issue 5) CEBS believes the recommendation cannot be considered to be met in its entirety.</p>

		not on the legal certainty of settlement operations. However, as far as the lack of legal certainty implies a higher legal risk for those institutions providing settlement services, the CRD provides an indirect tool to incentivise banks to confine their operations to legal frameworks that provide an appropriate degree of legal certainty.	
<i>1. As a general rule, the rights, liabilities and obligations arising from laws, regulations, rules and procedures, and from generally applicable, non-negotiable contractual provisions governing the operation of securities settlement systems, links (see Recommendation 19) and interoperable systems, should be clearly stated, understandable, public and accessible.</i>			
<i>2. The legal framework should demonstrate a high degree of legal assurance for each aspect of the clearing and settlement process, including legally valid and enforceable arrangements for netting and collateral.</i>			
<i>3. The rules and contractual arrangements related to the operation of the securities settlement systems and the</i>			

<p><i>entitlement to securities should be valid and enforceable, even in the event of the insolvency of a system participant, a participant in a linked or interoperable system, or the operator of the system or operators of linked or interoperable systems.</i></p>			
<p><i>4. The operators should identify the relevant jurisdictions for each aspect of the clearing and settlement process, and should address any conflict of law issues for cross-border systems.</i></p>			
<p><i>5. All eligible CSDs governed by the law of an EEA Member State should apply to have their securities settlement systems designated under the European Directive 98/26/EC on settlement finality in payment and securities settlement systems, as amended (hereinafter referred to as the Settlement Finality Directive). The relevant authorities should actually designate the systems that meet the criteria of the Settlement Finality Directive</i></p>			<p>The Settlement Finality Directive (SFD) only applies to those institutions designated as systems by the Member States. Therefore the SFD does not directly address the possibility of credit institutions performing a settlement service.</p> <p>The CRD does not directly address this issue either. The CRD focuses on banks' financial soundness and not on the prevention of securities market disruption through requiring a specific design of the settlement system.</p> <p>However the custodian bank that provides settlement services will have a greater exposure to operational, legal and</p>

			<p>reputational risk if the design of the internal settlement system is not appropriate.</p> <p>In this regard it could be argued that the CRD indirectly incentivises banks to design their internal systems according to good standards and best practices to properly manage the relevant risks.</p>
<p>6. For systemic risk purposes, the relevant public authorities should support the harmonisation of rules so as to minimise any discrepancies stemming from different national rules and legal frameworks</p>			

ESCB-CESR RSSS 2: Trade Confirmation and Settlement Matching	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>Confirmation of trades between direct market participants should occur as soon as possible after trade execution, but no later than trade date (T+0). Where confirmation of trades by indirect market participants (such as institutional investors) is required, it should occur as soon as possible after trade execution, preferably on T+0, but no later than T+1.</i></p>	<p>Relevant only to custodian banks internalising settlement</p> <p>The recommendation mainly refers to the design of the systems. It is therefore relevant only to the custodian banks that internalise settlement activities, since similar rules to those relating to the CSD's activities should</p>	<p>Coverage can be ensured through the general provisions on operational risk in the CRD (Annex X of Directive 2006/48/EC).</p> <p>The general rule sets a 15% of capital requirement for custody activity under the basic indicator approach (Part I of Annex 10), leaving open the amount of capital required</p>	<p>Recommendation partially met</p> <p>The Recommendation addresses issues relating to general settlement procedures. As such, it is relevant to institutions that perform internal settlement. The recommendation's central aim is for the confirmation of trades to occur as soon as possible. There is an operational risk linked to</p>

<p><i>Settlement instructions should be matched as soon as possible and, for settlement cycles that extend beyond T+0, this should occur no later than the day before the specified settlement date.</i></p>	<p>be applied.</p>	<p>under the more advanced approaches.</p> <p>In the standardised approach (part 2 of Annex 10) the "Payment and settlement" business line refers to "Money transmission services, Issuing and administering means of payment" and the "Agency services" business line refers to "Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management".</p> <p>Moreover Pillar II encourages banks to properly monitor, control and manage the risks the institution is exposed to. In this regard as far as these recommendations can be considered as the best standards for the design of a settlement system, the CRD would indirectly provide incentives for institutions to follow these recommendations.</p>	<p>this activity/task, which increases with the length of the confirmation period.</p> <p>There is a general operational risk provision in the CRD that covers custody activity. However, it should be noted that the internal settlement "business line" is not recognised in any specific line although this activity has specific operational risks.</p>
<p><i>1. Confirmation of trades between direct market participants should occur as soon as possible after trade execution, but no later than T+0.</i></p>			
<p><i>2. When confirmation/affirmation</i></p>			

<p><i>of trades by indirect market participants is required by regulators, clearing systems or market participants, it should occur as soon as possible after trade execution, preferably on T+0, but no later than T+1.</i></p>			
<p><i>3. Settlement instructions should be matched prior to settlement and no later than the day before the specified settlement date for settlement cycles longer than T+0. This does not apply to free-of-payment transfers in those systems where matching is not required.</i></p>			

ESCB-CESR RSSS 3: Settlement Cycles and Operating Times	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>Rolling settlement should be adopted in all securities markets. Final settlement should occur no later than T+3. The benefits and costs of EU-wide settlement cycles shorter than T+3 should be evaluated. The operating hours and days of CSDs should be open at least during the operating time of the relevant payment system (at least during TARGET2 operating times for transactions denominated in euro).</i></p>	<p>Not relevant</p> <p>The recommendation mainly refers to the design of the system and the efficiency of the settlement operations for settlement customers.</p> <p>The recommendation is not relevant to custodian banks performing solely custody services since any existing risks are borne by the market participants.</p>	<p>-</p>	<p>-</p>

ESCB-CESR RSSS 4: Central Counterparties – CCPs	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>The benefits and costs of establishing a CCP should be evaluated. Where a CCP mechanism or guarantee arrangement has been introduced, it should be assessed against the ESCB-CESR Recommendations pertaining to CCPs or against the checklist for guarantee arrangements respectively.</i></p>	<p>Not relevant</p> <p>The recommendation is not relevant since it is not specifically addressed to the activities of custodian banks.</p>	-	-

ESCB-CESR RSSS 5: Securities Lending	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>Securities lending and borrowing (or repurchase agreements and other economically equivalent transactions) should be encouraged as a method for avoiding settlement failures and expediting the settlement of securities. Barriers that inhibit the practice of lending securities for this purpose should be removed. The arrangements for securities lending should be sound, safe and efficient.</i></p>	<p>Relevant to all custodian banks</p> <p>The objective of this recommendation is to encourage securities lending as a way of smoothing the settlement operation while at the same time taking account of the risks stemming from securities lending.</p> <p>From a risk point of view, this is an activity that can be developed by any credit institution and is thus relevant to all custodian</p>	<p>Securities lending and borrowing are defined in Article 3 (n) of Directive 2006/49/CE.</p> <p>In general, Directive 2006/48/CE, Annex VIII is applicable, as it is considered a collateralised transaction. But it should not be regarded directly as a mitigant to the risk of market disruption. In addition, Article 78 directly addresses securities lending/borrowing.</p>	<p>Recommendation met.</p> <p>The CRD does not pose any barrier to custodian banks providing securities lending either as a participant in the settlement market or as a provider of internal settlement.</p> <p>The 'risk' part is covered for all custodian banks in the CRD.</p> <p>On the other hand, it should be noted that the CRD does not directly 'encourage' specific practices to mitigate risks of settlement market disruption.</p>

	<p>banks.</p> <p>From the point of view of securities lending as a tool for smoothing settlement operations, it is only relevant to custodian banks that internalise settlement.</p> <p>For those custodian banks that provide internal settlement services securities lending could be a way of smoothing the functioning of the internal settlement operations. As far as the smooth functioning of this service implies less operational, legal and reputational risk for the custodian bank it is also relevant from a prudential point of view.</p>		<p>However those banks that provide settlement services will be more exposed to operational, legal and reputational risk if they do not provide securities lending to their settlement customers.</p> <p>In this regard it could be argued that the CRD indirectly incentivises banks to provide securities lending in connection with internal settlement as a way of managing the above-mentioned risks.</p>
<p><i>1. The relevant public authorities should remove any impediments (e.g. legal, tax and accounting framework) to the development and functioning of securities lending.</i></p>			
<p><i>2. Securities lending and borrowing should be encouraged as a method for expediting securities settlement and reducing settlement failures. Where they exist, securities lending arrangements should meet the</i></p>			<p>Neither securities lending nor REPO operations have been originally designed for “avoiding settlement failures”. Both operations are part of the normal day to day operations of the banks that are allowed to do</p>

<p><i>requirements of the particular market in order to minimise settlement failures. Securities lending services, in connection with securities settlement processes, can be arranged bilaterally or as an automated and centralised facility.</i></p> <p><i>3. A centralised securities lending facility can be an efficient mechanism for reducing settlement failures. However, in markets where the number of settlement failures remains low, centralised securities lending arrangements may not be justified from a cost-benefit perspective.</i></p>			<p>them – as market participants. Nevertheless, both transactions can be used for covering short positions in some cases, and therefore, will help the banks to settle their transactions.</p> <p>Moreover those banks that provide settlement services will be more exposed to operational, legal and reputational risk if they do not provide securities lending to their settlement customers.</p> <p>In this regard it could be argued that the CRD indirectly incentivises the banks to provide securities lending in connection with internal settlement as a way to manage the above-mentioned risks.</p>
<p><i>4. Supervisors and overseers should have policies and procedures to ensure that risks stemming from securities lending activities are appropriately managed by entities subject to their supervision and oversight.</i></p>			<p>The CRD covers this provision insofar as it requires internal controls and procedures to be at an adequate level.</p>
<p><i>5. In order to preserve its financial integrity, the principal to centralised securities lending arrangements should apply adequate risk management and mitigation measures in line with the requirements set out in</i></p>			

<i>Recommendation 9.</i>			
<i>6. Entities providing securities lending for securities settlement should in no case be allowed to run debit balances or to create securities. Clients' assets should only be used with their explicit consent. See also key issues 5 and 6 of recommendation 12.</i>			MiFID provisions cover these aspects.

ESCB-CESR RSSS 6: Central Securities Depositories – CSDs	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<i>Securities should be immobilised or dematerialised and transferred by book entry in CSDs to the greatest possible extent. To safeguard the integrity of securities issues and the interests of investors, the CSD should ensure that the issue, holding and transfer of securities are conducted in an adequate and proper manner.</i>	<p>Relevant to all custodian banks</p> <p>Since some CSD functions (such as maintaining securities accounts, transferring securities via book entry and facilitating corporate actions) are also performed by most if not all custodian banks the recommendation is considered to be relevant to all custodian banks.</p> <p>It is even more important for those custodian banks that perform CSD-like business.</p> <p>The recommendation mainly requires a sound organisation that ensures investors'</p>	<p>There is no specific provision in the CRD to address this issue.</p> <p>However, MiFID has in place the necessary provisions to address the issue:</p> <ul style="list-style-type: none"> - Directive 2004/39/EC, Article 13 specifies organisational requirements ensuring investors' protection. - Directive 2006/73/EC, Articles 16 to 19 further elaborate on the organisational requirements mentioned under the Level 1 Directive. 	<p>Recommendation met:</p> <p>The application of MiFID ensures the same outcome as the application of the recommendation.</p>

	protection.		
<i>1. Immobilisation or dematerialisation and transfer by book entry in CSDs should be implemented to the greatest possible extent.</i>			
<i>2. The recording and transfer of securities issued in a CSD or an entity which performs CSD functions should be based on best accounting practices and end-to-end audit trails, which will help to ensure the integrity of the issue and safeguard the interests of the investors.</i>			
<i>3. As CSDs uniquely combine the provision of final settlement with the recording of changes in legal title resulting from securities transactions they should avoid credit and liquidity risk to the greatest possible extent. CSDs have to mitigate their associated risks in accordance with the requirements set out in these recommendations. Besides, the risks involved in offering CCP services are of a different nature to those raised by performing CSD activities and</i>			

<i>therefore require exceptionally high levels of risk management that necessitate separating the CCP services into a distinct legal entity.</i>			
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ESCB-CESR RSSS 7: Delivery versus Payment – DvP	Relevance to custodian banks	CRD and/or other provisions	Outcome of the ‘mapping’
<i>Principal risk should be eliminated by linking securities transfers to fund transfers in a way that achieves delivery versus payment.</i>	<p>Relevant only to custodian banks internalising settlement</p> <p>Because it aims to protect their customers by minimising the credit exposure between two parties to a trade that settle the transaction in the books of the custodian bank. It also protects against the creation of artificial securities.</p>	<p>Operational Risk provisions under Annex X of Directive 2006/48/EC address this issue.</p> <p>Moreover Pillar II encourages banks to properly monitor, control and manage the risks the institution is exposed to. In this regard as far as DvP can be considered as the best practice, the CRD would indirectly provide incentives for the use of this arrangement when performing internal settlement.</p>	<p>Recommendation indirectly met</p> <p>The CRD does not directly address this issue, because the CRD is focused on banks’ financial soundness and not on preventing securities market disruptions through requiring a specific design of the settlement system.</p> <p>However banks that provide settlement services will be more exposed to operational, legal and reputational risk if the design of the internal settlement system is not appropriate.</p> <p>In this regard it could be argued that the CRD indirectly incentives banks to design their internal systems according to good standards and best practices to properly manage the above-mentioned risk.</p> <p>The CRD provisions provide</p>

			<p>indirect coverage of the issue addressed by the recommendation through its operational risk provisions (which also includes legal risk).</p> <p>Where the custodian bank does not offer DvP it exposes its clients to counterparty risk but in any case faces operational and legal risks, which are covered by the CRD. The CRD, by requiring capital against these risks, indirectly encourages DvP rather than free deliveries.</p>
<i>1. The technical, legal and contractual framework should ensure DVP.</i>			
<i>2. All securities transactions against cash between direct participants of the CSD should be settled on a DVP basis.</i>			
<i>3. The length of time between the blocking of the securities and/or cash payment and the moment when deliveries become final should be minimised.</i>			

ESCB-CESR RSSS 8: Timing of Settlement Finality	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
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<p><i>Intraday settlement finality should be provided through real-time and/or multiple-batch processing in order to reduce risks and allow effective settlement across systems</i></p>	<p>Relevant only to custodian banks internalising settlement</p> <p>Custodian banks internalising settlement should manage these operational issues since the effects of settling transactions internally or via the CSD should be neutral for their clients.</p>	<p>The CRD refers to corporate governance and internal controls, but it does not specifically address the issue of settlement finality.</p>	<p>Recommendation not met</p> <p>The Settlement Finality Directive is not applicable to custodian banks as they are not designated as “systems”</p> <p>The risks for the custodian banks internalizing settlement are both of a legal and reputational nature, for example where a client seeks indemnity from the custodian for a settlement failure that occurred in the custodian bank’s own books</p> <p>The CRD does not directly address this issue, because the CRD focuses on banks’ financial soundness and not on preventing securities market disruption through requiring a specific design of the settlement service.</p> <p>However the bank that provides settlement services will be more exposed to operational, legal and reputational risk if the design of its internal settlement system is not appropriate.</p>
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<p><i>1. The timing of settlement finality has to be clearly defined in the rules of the systems, which require transfer orders and deliveries of securities and payment to be irrevocable, enforceable and supported by the legal framework.</i></p>			
<p><i>2. Settlement finality should be provided in real time and/or by multiple-batch processing during the settlement day. Where multiple-batch processing is used, there should be a sufficient number of batches distributed across the settlement day so as to allow interoperability across systems in the EU and to allow securities transferred through links to be used during the same settlement day by the receiver.</i></p>			
<p><i>3. The settlement system and its participants should execute the transactions without undue delay as soon as securities and cash are available.</i></p>			
<p><i>4. The rules of the system should prohibit the unilateral revocation of unsettled transfer instructions late in the settlement day.</i></p>			

ESCB-CESR RSSS 9: CSD Risk Controls to Address Participants' Failures to Settle	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>CSDs that extend intraday credit to participants, including CSDs that operate net settlement systems, should institute risk controls that, as a minimum, ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle. The most reliable set of controls is a combination of collateral requirements and limits.</i></p>	<p>Relevant to all custodian banks</p> <p>In cases where a custodian bank provides credit to other parties, the treatment of that risk position should be the same as custodian bank's other positions and hence this recommendation is relevant.</p> <p>Custodian banks that extend intra-day credit may be left with positions that add to their overall credit and liquidity risk exposure.</p>	<p>Credit risk control is extensively referred to in Directive 2006/48/EC while liquidity risk control is mentioned, in the form of high level principles, in some Articles of the same Directive.</p> <p>The CRD requires both quantitative risk control measures through minimum capital requirements as well as qualitative measures, such as the robust governance arrangements required in Article 22 of the Directive 2006/48/EC.</p> <p>Annex V, No 3, requires sound criteria for credit-granting, on-going administration/monitoring and adequate diversification.</p> <p>In addition to the CRD, the recent CEBS advice to the Commission specifically refers to the management of liquidity risk. Recommendation 10 in particular states that "Institutions should have cash and collateral management systems that adequately reflect the procedures and processes</p>	<p>Recommendation met</p> <p>The CRD states that credit institutions and, thus, custodian banks should apply risk controls to their overall exposure. Whilst the CRD does not explicitly address the intra-day component as required by this Recommendation, the CRD provides the tools to monitor intraday exposures and grants supervisors the tools for supervisory coordination and monitoring of these exposures.</p> <p>The recent CEBS advice on liquidity risk addresses the robustness of an organisation's risk management, taking into account all liquidity risks, including intra-day. This could also be considered as addressing to some degree the liquidity provisions contained in this recommendation.</p> <p>Regarding the reference to collateral and limits, the CRD also mentions these 2 elements. They are listed as risk mitigants:</p> <ul style="list-style-type: none"> – collateral, because the capital requirements are lower

		<p>of different payment and settlement systems in order to ensure effective monitoring of their intraday needs, at the legal entity level as well as at the regional or group level, depending on the liquidity risk management in place.”</p> <p>The CRD also imposes large exposure limits to control credit exposures: a) an aggregate limit of 25% for lending to connected counterparties; b) a 25% limit on all individual counterparties. Regular reporting is required for any large exposures exceeding 10% of own funds as described in the CRD.</p>	<p>the greater the quality of the collateral; and</p> <p>- limits, as a general rule. In both cases, there is indirect encouragement to use these 2 possibilities in the risk management and control framework as risk mitigants.</p>
<p><i>1. A CSD that extends intraday credit to participants should, at a minimum, ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle. Risk controls should be imposed to control potential losses and liquidity pressures from participants' failures to settle.</i></p>		<p>Article 75 (b) (Minimum level of own funds) of Directive 2006/48/EC.</p> <p>Annex VII, Part 4, 108 (Effectiveness of systems for controlling collateral, credit availability, and cash) of Directive 2006/48/EC.</p>	<p>The existing Article refers to the qualitative assessment of various types of risk faced by credit institutions. Custodian banks may face additional risk positions from the on-going settlement procedure. However, the risk of these positions is dealt with in the existing parts of Directive 2006/48/EC (counterparty credit risk, large exposures, etc.).</p>
<p><i>2. Overdrafts or debit balances in securities should not be permitted.</i></p>		<p>Overdrafts or debit balances in securities are not permitted, but there is the possibility that repo transactions can be</p>	

		undertaken. However, repos are covered in Directive 2006/49/EC.	
<i>3. The probability and potential impact of multiple settlement failures should be evaluated relative to the costs to ensure settlement in such an event.</i>		In the recitals, paragraph (16), to Directive 2006/49/EC it is stated that it is necessary to develop common standards for market risks incurred by credit institutions and provide a complementary framework for the supervision of the risks incurred by institutions, in particular market risks, and more especially position risks, <i>counterparty/settlement risks</i> and foreign-exchange risks.	

ESCB-CESR RSSS 10: Cash Settlement Assets	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<i>Assets used to settle payment obligations arising from securities transactions should carry little or no credit or liquidity risk. If central bank money is not used, steps must be taken to protect the participants in the system from potential losses and liquidity pressures arising from the failure of the cash settlement agent whose assets are used for that purpose"</i>	<p>Relevant only to custodian banks internalising settlement</p> <p>Since the recommendation addresses the quality of the assets used in the settlement procedure.</p>	<p>The issue is addressed in Directive 2006/48/EC, Articles 90 to 93 and Annex VIII.</p> <p>For the transactions that give rise to a direct risk to custodian banks the CRD defines eligible collateral for mitigation purposes. If the collateral is eligible, certain haircuts apply for the different sources of risk (price risk, fx risk) taking into account the maturity mismatch (between the underlying asset and the</p>	<p>Recommendation indirectly met</p> <p>The use of collateral for credit risk mitigation purposes is set out in the CRD so that when the risk is directly borne by the custodian bank it is aligned with the recommendation.</p> <p>However, in accordance with the recommendation counterparties in the settlement procedure are free to define the eligible assets they are willing to accept from</p>

		<p>collateral).</p> <p>When the transaction does not give rise to a direct risk for the custodian bank but for the settlement customers, the CRD still provides indirect incentives to follow the recommendation as a way of preventing other risks (operational, legal and reputational) borne by the custodian bank when performing internal settlement.</p>	<p>their customers. In this sense, the recommendation is slightly more relaxed than the framework described by the CRD where eligible collateral, and its use, is clearly defined.</p> <p>Regarding the use of assets to settle payment obligations when the custodian bank is directly exposed to these assets, the CRD can be considered stricter than the recommendation.</p> <p>When customers themselves are exposed, the CRD provides indirect coverage through general incentives for the custodian banks to perform their activities in ways that limit risks stemming from these activities.</p> <p>Comments made on RSSS9 relating to the collateral provisions also apply here.</p>
<p><i>1. For transactions denominated in the currency of the country where the settlement takes place, CSDs should settle cash payments in central bank money whenever practicable and feasible. For this reason, central banks may need to enhance the operational mechanisms used for the provision of central bank money.</i></p>			

<p><i>2. If central bank money is not used as asset to settle obligations in a currency, steps must be taken to protect participants from potential losses and liquidity pressures arising from the failure of the cash settlement agent whose assets are used for that purpose. Where both central and commercial bank money facilities are offered, the choice to use commercial bank money should be at the sole discretion of the participant.</i></p>			
<p><i>3. Only regulated financial institutions with robust legal, financial and technical capacity, in accordance with EU prudential (or equivalent) regulation, should be allowed to act as cash settlement agents. When central bank money is not used, the CSD acting as cash settlement agent should put in place adequate risk measures as described in Recommendation 9 in order to protect participants from potential losses and liquidity pressures. There should be sufficient information for market participants to identify and evaluate the risks and costs associated with these services.</i></p>			
<p><i>4. The proceeds of securities settlements should be available for recipients to use as soon as possible on an intraday basis, or</i></p>			

<i>at least on a same-day basis.</i>			
<i>5. The payment systems used for interbank transfers among settlement banks should observe the Core Principles for Systemically Important Payment Systems (CPSIPS).</i>			

ESCB-CESR RSSS 11: Operational Risk	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>Sources of operational risk arising in the clearing and settlement process should be identified, monitored and regularly assessed. This risk should be minimised through the development of appropriate systems and effective controls and procedures. Systems and related functions should (i) be reliable and secure, (ii) be based on sound technical solutions, (iii) be developed and maintained in accordance with proven procedures, (iv) have adequate, scalable capacity, (v) have appropriate business continuity and disaster recovery plans that allow for the timely recovery of operations, and (vi) be subject to frequent and independent audits.</i></p>	<p>Relevant to all custodians</p> <p>All custodian banks are subject to operational risk as part of their day-to-day operations.</p> <p>This recommendation is especially relevant to those custodian banks that are internalisers. For these banks the operational risk could lead to a financial stability risk through the risk to the solvency/liquidity of the institution and, secondly, through the risk of disruption in the securities market where the custodian bank provides internal settlement.</p>	<p>All banks are subject to capital requirements for operational risk for all activities performed and there are several recommendations regarding measurement, management and monitoring of operational risk.</p> <p>In particular Articles 102 -105, and Annex X on Operational Risk (e.g. in Part 2 on the Standardized approach there are capital requirements for agency services: "Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management")</p> <p>In addition, CEBS Guidelines on Validation (published on April 2006), in particular part 4</p>	<p>Recommendation met</p> <p>Operational risk stemming from custody services is covered in the CRD.</p> <p>The general rules addressing sound operational risk management are applicable to custodian banks, performing all the activities related to custody (including internal settlement).</p>

		on the supervisory assessment of validation regarding operational risks, contains guidance on the implementation, validation and assessment of the risk management and risk measurement systems used by credit institutions and investment firms for the calculation of their capital requirements.	
<p><i>1. Sources of operational risk in clearing and settlement activities (including systems operators) and related functions/services should be regularly identified, monitored, assessed and minimised. Clear policies and procedures should be established to address those risks, including risks from those operations that are outsourced to third parties.</i></p>		<p>Article 22 (general risk management standard) of Directive 2006/48/EC.</p> <p>Annex V, paragraph 12 (technical criteria concerning the organisation and treatment of Operational Risk) of Directive 2006/48/EC.</p> <p>Article 123 (credit institutions' assessment processes) of Directive 2006/48/EC.</p> <p>Annex X, part 3, paragraph 12 (Operational Risk – Advanced Measurement Approaches) of Directive 2006/48/EC.</p>	<p>When the CRD refers to risk management in general, operational risk arising from custody operations can be considered to be included. So, Article 22 and Article 123, as well as Annexes X, and V, would refer (at least indirectly) to this point. Regarding minimisation of operational risk, even if there is not a direct reference to it, there is an implicit reference to it when capital is required, and the CRD explicitly requires capital for this risk.</p>
<p><i>2. Operational risk policies and procedures should be clearly defined, frequently reviewed and updated and tested to remain current. The responsibilities of the relevant governance bodies and</i></p>		<p>Article 22 (general risk management standard) of Directive 2006/48/EC.</p> <p>Annex V, paragraphs 2 and 12 (technical criteria concerning</p>	<p>Article 22 addresses the key issue “responsibilities of the relevant governance bodies and senior management” directly, whereas “periodic independent audit of the information system”</p>

<p><i>senior management should be clearly established. There should be adequate management controls and sufficient (and suitably well-qualified) personnel to ensure that procedures are implemented accordingly. Information systems should be subject to periodic independent audit.</i></p>		<p>the organisation and treatment of Operational Risk) of Directive 2006/48/EC.</p>	<p>is only mentioned implicitly which should be appropriate. The audits conducted by competent authorities in terms of Article 124 should not be taken into account.</p> <p>The requirements referring to policies and procedures are covered by Annex V paras. 2 and 12.</p> <p>The requirement concerning staffing is not addressed explicitly. However this requirement could be derived from Article 123 which requires comprehensive strategies and processes which can only be achieved when sufficient and suitably qualified personnel are in place.</p>
<p><i>3. There should be business continuity and disaster recovery plans to ensure that the system is able to resume business activities, with a reasonable degree of certainty, a high level of integrity and sufficient capacity as soon as possible after the disruption. Contingency plans should, as a minimum, provide for the recovery of all transactions at the time of the disruption to allow systems to</i></p>		<p>Annex V, para 13 (technical criteria concerning the organisation and treatment of Operational Risk) of Directive 2006/48/EC.</p> <p>Article 123 (credit institutions' assessment processes) of Directive 2006/48/EC.</p> <p>Article 22 (general risk management standard) of Directive 2006/48/EC.</p>	<p>The requirement for the existence of a business continuity plan and the capacity for an early resumption of business activities is directly covered by Annex V, para 13. The requirement for appropriate back-up facilities is not mentioned directly but can implicitly be derived from Annex V, para. 13 which requires the ability to operate on an on-going basis and to limit</p>

<p><i>continue to operate with certainty. A second site should be set-up in order to meet these obligations. Business continuity and disaster recovery plans should be tested on a regular basis and after any major modifications to the system. Adequate crisis management structures, including formal procedures, alternative means of communication and contact lists (both at local and cross-border level) should be available.</i></p>			<p>losses in the event of severe business disruption.</p> <p>The same is true of the requirements regarding the application of regular tests, adequate management structures, alternative means of communication and contact lists, which are not designated explicitly but which can be derived implicitly from the requirement for contingency plans.</p> <p>The requirement for sufficient capacity is addressed by Article 22 No. 2. Indeed, the processes mentioned in Article 22 comprise the systems mentioned in standard 11.</p>
<p><i>4. All key systems should be reliable, secure and able to handle stress volume.</i></p>		<p>Article 22 (general risk management standard) of Directive 2006/48/EC.</p>	<p>In a broader sense these issues should be covered by Article 22 No 2 CRD but the criteria Security and Reliability are not explicitly mentioned. However, as there is a specific capital demand for operational risk associated with custody activities, this risk could be regarded as indirectly covered. The importance of sound internal processes and back-up systems is even more important when dealing with clients' orders, as the institution is acting on behalf of its clients, so</p>

			the maximum protection for them must be ensured. Moreover the necessity for Security and Reliability and their importance for CSDs can be derived from the "proportionality" criterion laid down in Article 22.
<p>5. CSDs should only outsource settlement operations or functions to third parties after the approval of the relevant competent authorities, if it is required by regulation. If it is not required, they should at least notify in advance the relevant competent authorities, and should ensure that the external providers meet the relevant recommendations. The relevant outsourcing entities should have the power to require adaptation of the outsourcing measures.</p>		<p>Article 123 (credit institutions' assessment processes) of Directive 2006/48/EC</p> <p>CEBS Guidelines on Outsourcing (14 December 2006). The aim of the CEBS guidelines is to promote an appropriate level of convergence in supervisory approaches to outsourcing. The proposed guidelines are based on current supervisory and market practices and also take into account international and European developments in the field of outsourcing.</p>	<p>The CEBS Guidelines on Outsourcing are at least as strict as ESBC-CESR; the ultimate responsibility for the proper management of the risks associated with outsourcing or the outsourced activities lies with an outsourcing institution's senior management.</p> <p>An outsourcing institution should take particular care when outsourcing material activities. The outsourcing institution should adequately inform its supervisory authority about this type of outsourcing.</p>

ESCB-CESR RSSS 12: Protection of Customers' Securities	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>Entities holding securities in custody should employ accounting practices and safekeeping procedures that fully protect customers' securities. It is</i></p>	<p>Relevant to all custodian banks</p>	<p>The issue is addressed by MiFID Article 13 (7) and (8):</p> <p>"7. An investment firm shall, when holding financial</p>	<p>Recommendation met:</p> <p>The recommendation is mainly covered by MiFID. The legal risk is covered by the operational</p>

<p><i>essential that customers' securities be protected against the claims of the creditors of all entities involved in the custody chain.</i></p>		<p>instruments belonging to clients, make adequate arrangements so as to safeguard clients' ownership rights, especially in the event of the investment firm's insolvency, and to prevent the use of a client's instruments on own account except with the client's consent.</p> <p>8. An investment firm shall, when holding funds belonging to clients, make adequate arrangements to safeguard the clients' rights and, except in the case of credit institutions, prevent the use of client funds for its own account."</p>	<p>risk provisions in Directive 2006/48/EC in Annex X (Operational Risk).</p>
<p><i>1. An entity holding securities in custody should employ best accounting practices, and should segregate in its books customers' securities from its own securities so as to ensure that customer securities are protected, particularly against claims of the entity's creditors.</i></p>		<p>MiFiD Article 13 (7).</p>	<p>The issue is covered in MiFID, even with regard to the segregation aspect.</p>
<p><i>2. At regular intervals, and at least once a day, entities holding securities in custody should reconcile their records (e.g. with the issuer CSD, the investor CSD or a custodian bank, depending on the tiering of the custody chain) so as to ensure that</i></p>		<p>MiFiD Level 2 Implementing Measures Article 16: Safeguarding of client financial instruments and funds No. 1.</p>	<p>The issue is covered in the MiFID.</p>

<i>customer claims can be satisfied, in line with the implementation of MiFID.</i>			
<i>3. In addition to Key Issue 1, national law should ensure that customer securities are kept immune from any claims made by creditors of the entity holding the securities in custody or by entities upstream in the custodial chain.</i>		MiFiD Article 13 (7).	The issue is covered in MiFID.
<i>4. Entities holding securities in custody should audit their books on a regular basis to certify that their clients' individual securities holdings correspond to the global clients' positions that the entities register in the CSD's, registrar's or depository's books. Entities should submit audit reports to supervisory and oversight authorities upon request.</i>		Article 22 of Directive 2006/48/EC and Annex 5 (internal auditing) and Article 124 of Directive 2006/48/EC and Article 50, para. 2 MiFID (submission of reports).	The aspects are covered in CRD and MiFID respectively.
<i>5. Entities holding securities in custody must not use customer securities for any purpose unless they have obtained the customer's explicit consent. Their records shall include details of the client and of the financial instruments that they may have used to enable the correct calculation in any loss allocation mechanism that might be applicable.</i>			The issue is covered in MiFID.
<i>6. In no case should securities</i>			No corresponding prohibition in

<i>debit balances or securities creation be allowed by entities holding securities in custody.</i>			CRD.
<i>7. When securities are held through several intermediaries, the entity with which the customer holds the securities should ascertain whether adequate procedures for its customers' protection are in place (including, where relevant, procedures applicable to all upstream intermediaries), and should inform the customers accordingly.</i>		MiFiD Article 13 (5).	The issue is covered in MiFID.
<i>8. Entities holding securities in custody should be regulated and supervised.</i>	CRD and MiFiD is applicable to Custodian banks	MiFiD Article 13 (6). MiFiD Article 5 and Title IV. Chapter I. Article 6 and Title V Chapter I. Section 1. and Chapter 4 Section1 of Directive 2006/48/EC.	Custodian banks are subject to regulation via CRD and MiFiD

ESCB-CESR RSSS 13: Governance	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<i>Governance arrangements for CSDs should be designed to fulfil public interest requirements and to promote the objectives of owners and market participants.</i>	Relevant to all custodian banks This recommendation is addressed to CSDs especially in their function of being the	The OECD corporate governance principles (applicable to companies of OECD Member States), the CEBS internal governance guidelines (Appendix 1) and	Recommendation met OECD corporate governance principles, CEBS guidelines and specific CRD requirements in relation to governance

	<p>heart of the settlement process.</p> <p>Given the fact that the boundary between custody banks and CSD is blurring this recommendation should be relevant for custody banks as well.</p>	<p>the BIS's 2006 paper "Enhancing corporate governance for banking organisations" address internal governance, and the role of supervisors.</p> <p>Article 22 (general risk management standard) of Directive 2006/48/EC.</p> <p>OECD corporate governance principles (applying to companies of OECD Member States).</p>	<p>arrangements address all the relevant issues.</p>
<p><i>1. Governance arrangements should be clearly specified and transparent.</i></p>		<p>OECD corporate governance principles and CRD Article 22.</p>	<p>Covered by OECD corporate governance principles and CRD Article 22</p>
<p><i>2. Objectives and major decisions should be disclosed to the owners, market participants and public authorities involved.</i></p>		<p>OECD corporate governance principles and CRD Article 22.</p>	<p>Covered by OECD corporate governance principles and CRD Article 22</p>
<p><i>3. Management and the Board of Directors ("the Board") should have the incentives and skills needed to achieve objectives, and should be fully accountable for their performance.</i></p>		<p>OECD corporate governance principles and CRD Articles 11 and 22.</p>	<p>Covered by OECD corporate governance principles and CRD Articles 11 and 22.</p>
<p><i>4. The Board or the relevant governance body should have the required expertise and take all relevant interests into account.</i></p>		<p>OECD corporate governance principles and CRD Articles 11 and 22.</p>	<p>Covered by OECD corporate governance principles and CRD Articles 11 and 22.</p>
<p><i>5. Governance arrangements</i></p>			<p>CRD contains explicit</p>

<p><i>should include the identification of conflicts of interest and should use resolution procedures whenever there is a possibility of such conflicts occurring.</i></p>			<p>requirements in relation to the separation of duties (for IRB institutions Annex VII, Part 4, point 109).</p>
<p><i>6. When appropriate, the relevant appropriate decision-making level of the CSD should approve the limits on total credit exposure to participants, and on any large individual exposures. When there is a risk of a conflict of interests, such a decision should be taken with due regard to this conflict of interests.</i></p>		<p>Credit risk exposure limits are set in different articles of the CRD.</p> <p>Conflicts of interests are addressed by MiFID.</p>	<p>CRD contains explicit requirements on credit risk management and the separation of duties (for IRB institutions Annex VII, Part 4, point 109).</p>

<p>ESCB-CESR RSSS 14: Access</p>	<p>Relevance to custodian banks</p>	<p>CRD and/or other provisions</p>	<p>Outcome of the 'mapping'</p>
<p><i>CSDs should have objective and publicly disclosed criteria for participation that permit fair and open access. Rules and requirements that restrict access should be aimed at controlling risk.</i></p>	<p>Not relevant</p> <p>The aim of this recommendation is to foster market integration.</p> <p>Therefore this is a matter mainly for the competition authorities and should be addressed by regulations other than banking regulation.</p> <p>The only point relevant to custodian banks is that they should be transparent about</p>	<p>-</p>	<p>-</p>

	their relationships with credit institutions. However, this is a general rule that banks in general must fulfil. In addition this is not a matter of risk, but of transparency.		
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ESCB-CESR RSSS 15: Efficiency	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<i>While maintaining safe and secure operations, securities settlement systems should be cost-effective in meeting the requirements of users.</i>	<p>Not relevant</p> <p>The recommendation is mainly a matter for other competent authorities and should be addressed by regulations other than banking regulation.</p>	-	-

ESCB-CESR RSSS 16: Communication Procedures, Messaging Standards and Straight-Through processing	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<i>CSDs and participants in their systems, should use or accommodate the relevant international communication procedures and standards for messaging and reference data in order to facilitate efficient clearing and settlement across systems. This will promote straight-through processing (STP) across the entire</i>	<p>Relevant to all custodian banks</p> <p>The recommendation addresses technical requirements and it is therefore relevant to all custodian banks. It is especially relevant for those custodian banks that</p>	Article 22 of Directive 2006/48/EC refers to general risk management standards.	<p>Recommendation indirectly met</p> <p>The CRD indirectly incentivises banks to use or accommodate the relevant international standards, as the use of these standards reduces the operational risk stemming from these operations.</p>

<p><i>securities transaction flow.</i></p> <p><i>For this recommendation to be effective, it also needs to be applied either directly or indirectly by other providers of securities communication services, such as messaging services and network providers.</i></p>	<p>internalise settlement.</p>		
<p><i>1. International communication procedures and standards relating to securities messages, securities identification processes and counterparty identification should be applied.</i></p>			

ESCB-CESR RSSS17: Transparency	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>CSDs should provide market participants with sufficient information for them to identify and accurately evaluate the risks and costs associated with securities clearing and settlement services.</i></p> <p><i>Addressed to CSDs to be effective, this recommendation also needs to be applied by other providers of securities services, such as trade confirmation services, messaging services and network providers.</i></p>	<p>Relevant to all custodian banks.</p> <p>The principle of providing market participants with sufficient information is relevant to all custodian banks.</p>	-	<p>Recommendation met:</p> <p>The CRD and the MiFID cover the recommendation sufficiently for those custodian banks that act as intermediaries. Whilst the CRD transparency requirements don't explicitly require those custodian banks that internalise settlement to make transparent their prices and fees, in the light of the general transparency objective CEBS has interpreted this Recommendation to be met by CRD and MiFID provisions.</p>

<p><i>1. CSDs shall provide market participants with the information necessary to evaluate the risks and prices/fees associated with the CSDs' settlement service; this information should include the main statistics and the balance sheet of the system's operator.</i></p>		<p>CRD Article 145 and Article 147.</p> <p>Further detail provided in CRD Annex XII.</p> <p>MiFID Article 19 (1)-(3) and (7)-(8);</p> <p>3. Appropriate information shall be provided in a comprehensible form to clients or potential clients about:</p> <ul style="list-style-type: none"> — the investment firm and its services, — financial instruments and proposed investment strategies; this should include appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies, — execution venues, and — costs and associated charges so that they are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on 	
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		<p>an informed basis. This information may be provided in a standardised format.</p> <p>Also MiFID Article 19 (1)-(2) and (7)-(8); and MiFID Article 21.</p> <p>Please also see Article 44 of Commission Directive 2006/73/EC.</p>	
<i>2. CSDs should publicly and clearly disclose their risk exposure policy and risk management methodology.</i>		<p>CRD Article 145-149</p> <p>CRD Annex XII.</p>	CRD covers the recommendation sufficiently.
<i>3. Information should be publicly accessible, for example via the internet, and not restricted to the system's participants. Information should be available in formats that meet the needs of the users and in a language commonly used in the international financial markets as well as in at least one of the domestic languages.</i>		<p>CRD Article 145-149</p> <p>CRD Annex XII.</p> <p>MiFID Article 13 (4)-(5); Article 19 (1)-(3) and (7)-(8); Article 21.</p>	CRD and MIFID cover the recommendation sufficiently.
<i>4. The accuracy and completeness of disclosures should be reviewed at least once a year by the CSDs. Information should be updated on a regular basis.</i>		CRD Article 147.	CRD covers the recommendation sufficiently.

ESCB-CESR RSSS 18:	Relevance to custodian	CRD and/or other	Outcome of the 'mapping'
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Regulation, Supervision and Oversight	banks	provisions	
<p><i>CSDs and securities settlement systems should be subject to transparent, consistent and effective regulation, supervision and oversight. In both a national and a cross border context, central banks and securities regulators should cooperate with each other and with other relevant authorities regarding the CSD and the securities settlement systems it operates. Central banks and securities regulators should also ensure a consistent implementation of the recommendations.</i></p>	<p>Relevant to all custodian banks</p> <p>Adequate regulation, supervision and oversight are relevant to custodian banks.</p>	<p>Addressed by the CRD and MiFID.</p>	<p>Recommendation met</p> <p>CRD provides for the supervision and regulation of banks in the area of prudential risk. MiFID further provides for the adequate supervision and regulation of conduct of business issues. Other regulations applying to banks include financial crime legislation, rules regarding collateral usage and others.</p> <p>In light of the range of regulations applicable to banks, this recommendation is considered to be met.</p>
<p><i>1. CSDs and securities settlement systems should be subject to transparent, consistent and effective regulation, supervision and oversight. Securities regulators (including in this context banking supervisors where they have similar responsibilities and regulatory authority for CSDs) and central banks should have the ability and the resources to carry out their regulation, supervision and oversight responsibilities effectively.</i></p>		<p>CRD Article 6 and Article 124.</p>	

<p>2. <i>Securities regulators and central banks should clearly define and publicly disclose their objectives, their roles and key aspects of major policies for CSDs.</i></p>			
<p>3. <i>To ensure transparent, consistent and effective regulation, supervision and oversight, different forms of cooperation amongst relevant authorities may be required, both in national and cross-border context. Central banks and securities regulators should also ensure the consistent implementation of the recommendations and to achieve a level playing field for CSDs and securities settlement systems in the European Union.</i></p>		<p>CRD Article 29-37. CRD Article 40-43.</p>	
<p>4. <i>To enable them to carry out their tasks securities regulators and central banks should require CSDs and operators of securities settlement systems/arrangements to provide information necessary for regulation, supervision and oversight in a timely manner, including information on operations that have been outsourced to third parties or where the CSD proposes to undertake new activities.</i></p>			

<p>5. <i>Securities regulators, central banks and other relevant authorities should cooperate with one another, both nationally and in a cross border context, to contribute to a safe, sound and efficient operation of CSDs.</i></p>		<p>CRD Article 15. CRD Article 42. CRD Chapter 4. Section 1. CRD Article 149.</p>	
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ESCB-CESR RSSS19: Risks in Cross-Systems Links or Interoperable Systems	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>CSDs that establish links to settle cross-system trades should design and operate such links so that they effectively reduce the risks associated with cross-system settlements. They should evaluate and mitigate the potential sources of risks that can arise from the linked CSDs and from the link itself.</i></p>	<p>Not relevant</p> <p>In the case of cross system trades between custodian banks, the banks either require the use of a CSD or internalise the settlement on the books of one of the respective custodian banks.</p>	<p>-</p>	<p>-</p>

Mapping the ESCB-CESR draft Recommendations for Central Counterparties (RCCP)

ESCB-CESR RCCP 1: Legal Risk	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>CCPs, linked or interoperable CCPs should have a well-founded, transparent and enforceable legal framework for each aspect of their activities in all relevant jurisdictions</i></p> <p>Key issues:</p> <p><i>1. The laws, regulations rules, procedures, and contractual provisions governing the operation of a CCP, of linked CCPs or of interoperable CCPs (see Recommendation 11) should be clearly stated, internally coherent, and readily accessible to participants and the public. Information to the public should include those topics specified in C.11.</i></p> <p><i>2. The legal framework should provide a high degree of assurance for each aspect of a CCP's operations and risk management procedures.</i></p> <p><i>3. The rules, procedures, and contracts of a CCP should be enforceable if a CCP participant, a linked CCP or an interoperable CCP or a participant in a linked or</i></p>	<p>Relevant only to custodian banks undertaking CCP-like activities</p> <p>The regulation of the CCP requires an adequate legal framework for them.</p> <p>As it is mainly refers to the general design of the system, in order to offer the maximum protection and transparency to users, it is relevant for the custodian banks that act as CCPs, to design a system that offers similar guarantees and information to their clients (for them, their "participants")</p> <p>For custodian banks that act as CCPs, the design should follow the global recommendations, and as banks they are under the supervisors' review. The risks assumed should be treated in the same way that the rest of the risks assumed by banks. So, the CRD should be fully applied.</p> <p>The recommendation requires</p>	<p>The CRD's general rules regarding credit risk and operational risk can be applied to this CCP function, as the bank that is acting as a CCP will have the credit risk of the transaction. However, the bank can demand collateral as a guarantee, so the credit risk will be mitigated. There are several provisions in the CRD regarding credit risks and their capital requirements, taking into account whether the transaction is collateralized or not, which can be fully applied in this case, as the bank will appear as the "counterparty" to the transaction.</p> <p>Regarding the transparency obligations with the participants, there are several provisions (in the MIFID) that directly address this subject.</p>	<p>Recommendation partially met</p> <p>See also RSSS 1, as the provisions are equivalent</p> <p>3 main areas should be distinguished:</p> <ul style="list-style-type: none"> - The transparency and the general risks assumed by the bank when acting as CCP: this part of the recommendation on how the design of the CCP should be done, in order to perform adequate risk management can be considered as covered by the CRD and other Directives - The legal part of the recommendation, specially key issue 4, should be regarded as not relevant, as it is directly addressed to the CCPs that are global systems and deal with cross-border participants - Key issue 5, regarding finality of transactions is

<p><i>interoperable CCP defaults or becomes insolvent. There should be a high degree of assurance that actions taken under such rules and procedures may not later be stayed, avoided or reversed</i></p> <p><i>4. A CCP should identify and address any potential conflicts of laws issues arising from cross-border arrangements. In doing this, the CCP's analysis should include the laws intended to cover those elements specified in C.8.</i></p> <p><i>5. In accordance with the relevant national implementation provisions, all CCPs should apply for designation under the Settlement Finality Directive 98/26/EC on settlement finality in payment and securities settlement systems, as amended (hereinafter referred to as the Settlement Finality Directive). The relevant authorities should actually designate the systems that meet the criteria of the Settlement Finality Directive.</i></p>	<p>that the operations performed by a CSD or a CCP have a well-founded, clear and transparent legal basis in the relevant jurisdiction and as such they are fully applicable to such custodian banks and clearing intermediaries.</p>		<p>not directly addressed in either the CRD or the MIFID.</p>
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ESCB-CESR RCCP 2: Participation Requirements	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
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<p><i>A CCP should require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the CCP. A CCP should have procedures in place to monitor that participation requirements are met on an ongoing basis. A CCP's participation requirements should be objective, publicly disclosed, and permit fair and open access. Rules and requirements that restrict access should be aimed at controlling risk.</i></p> <p>Key issues:</p> <p><i>1. To ensure timely performance by participants, a CCP should establish requirements for participation to ensure that participants have sufficient financial resources and robust operational capacity, including a sufficient level of relevant expertise, necessary legal powers and business practices.</i></p> <p><i>2. A CCP should have procedures in place to monitor that participation requirements are met on an ongoing basis, either through timely access to regulatory reports filed by participants or directly if such reports are not available or do not</i></p>	<p>Relevant to all custodian banks</p> <p>This recommendation is relevant to all custodian banks, including those acting as CCPs, as they should be able to ensure the quality of the customers to which they are exposed.</p>	<p>This issue is addressed by Directive 2006/48/EC, Title V, Chapter 2, Sections 3 to 5 (plus corresponding annexes), Guidelines from the FATF, Guidelines from the BCBS, notably on credit risk management, and Guidelines from CEBS on concentration risk.</p>	<p>Recommendation indirectly met</p> <p>The CRD provisions provide indirect coverage of the issue addressed by the recommendation.</p> <p>Indeed, risk weights may be considered - and thus capital requirements - as a function of the quality of the counterparties, providing incentives to carry out business with financially sound entities.</p> <p>Moreover, credit risk management and "know-your-customer" rules may provide for the necessary due diligence during the selection of new customers.</p>
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<p><i>contain the required information.</i></p> <p><i>3. Participation requirements should be objective, permitting fair and open access. Denial of access should only be based on risk-related criteria or other criteria as set out in EU law and should be explained in writing. Participation requirements, including arrangements for orderly exit of participants, should be clearly stated and publicly disclosed.</i></p>			
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ESCB-CESR RCCP 3: Measurement and Management of Credit Exposures	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>A CCP should measure its credit exposures to its participants at least once a day. Through margin requirements and other risk control mechanisms, a CCP should limit its exposures to potential losses from defaults by its participants so that the operations of the CCP would not be disrupted and non-defaulting participants would not be exposed to losses that they cannot anticipate or control.</i></p> <p>Key issues:</p>	<p>Relevant only to custodian banks undertaking CCP-like activities</p>	<p>This issue is addressed by Directive 2006/49/EC, Article 37, Paragraph 2; Directive 2006/49/EC, Annex I, Point 4; Directive 2006/49/EC, Annex V and also additional references to the market risk framework in the CRD.</p>	<p>Recommendation indirectly met</p> <p>The CRD provides the opportunity for credit institutions (including custodian banks) to follow internally developed models. These models (e.g. volatility estimates) can be used for the implementation of margin requirements. Custodian banks that act as CCPs can use the same approach and the same internal model to calculate margin requirements for their clients.</p>

<p>1. A CCP should measure its exposures to its participants at least once a day and should have the capacity to measure its exposures on an intra-day basis, either routinely or at a minimum when specified thresholds are breached. The information on market prices and participants' positions that are used to calculate the exposures should be timely.</p> <p>2. Through margin requirements and other risk control mechanisms, a CCP should ensure that it is adequately protected against potential losses from defaults by its participants, so that closing out any participant's positions would not disrupt the operations of a CCP or expose non-defaulting participants to losses that they cannot anticipate or control.</p>			<p>However, not all banks use internal models and it could be considered that a gap exists for custodian banks that follow the standardised approach. However, it should be noted that even when the custodian bank uses the standardized approach, it can set limits or monitor its daily risks from its clients.</p> <p>In addition, given the objective of margin calls is to cover the volatility of prices of financial instruments, the market risk framework within the CRD is also relevant in this respect and capital is required based on the risk.</p>
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RCCP 4: Margin Requirements	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>A CCP should to the greatest extent feasible impose margin requirements to limit its credit exposures to participants. These requirements should be sufficient to cover potential exposures that the CCP estimates to occur until</i></p>	<p>Relevant only to custodian banks undertaking CCP-like activities</p>	<p>-</p>	<p>Recommendation indirectly met</p> <p>See RSSS 3, as the same provisions are applicable.</p>

the liquidation of the relevant positions. The models and parameters used in setting margin requirements should be risk-based and reviewed regularly.

Key issues:

1. Margin requirements should be imposed where feasible and should be sufficient to cover losses that result from 99 % of the price movements over an appropriate time horizon. This time horizon should be appropriate to capture and identify the risk characteristics of the specific instrument in order to allow the CCP to estimate the magnitude of the price changes to be expected to occur in the interval between the last margin collection and the time the CCP estimates it will be able to liquidate the relevant positions. Models and parameters used in determining margin requirements are based on the risk characteristics of the products cleared and take into account the interval between margin collections. The ability of the models and parameters to achieve the desired coverage should be validated regularly.

2. A CCP should have the policy, the authority and operational

<p><i>capacity to make intraday margin calls to mitigate credit exposures arising from new positions or from price changes.</i></p> <p><i>3. The assets that a CCP accepts to meet margin requirements should be limited to highly liquid instruments. Haircuts should be applied to asset values that reflect the potential for their value to decline over the interval between their last revaluation and the time by which they can reasonably be assumed to be liquidated.</i></p>			
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ESCB-CESR RCCP 5: Other Risk Controls	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>A CCP should maintain sufficient available financial resources to cover potential losses that exceed the losses to be covered by margin requirements. For this purpose, the CCP should develop plausible scenarios and conduct stress tests accordingly. At a minimum, a CCP should be able to withstand a default by the participant to which it has the largest exposure in extreme but plausible market conditions.</i></p> <p>Key issues:</p>	<p>Relevant to all custodians</p> <p>Because the recommendation addresses internal regulation related to resources to cover potential losses and stress testing.</p>	<p>Article 75, requirement for holding adequate own funds, in connection with Annex VII, Part 4, points 40 to 42 (applies to IRB approach).</p> <p>Article 123 in conjunction with Article 124 (requirement for credit institutions to assess risks and for supervisors to check this assessment and to make sure that credit institutions hold sufficient own funds).</p> <p>Articles 106 to 119 (large</p>	<p>Recommendation met</p> <p>For credit institutions using the IRB approach or the Internal Models Method for the calculation of counterparty credit risk, the conduct of stress tests is explicitly required. Under Pillar II there is a general rule regarding the necessity of performing stress tests. Also in different international fora the importance of stressing risk has been highlighted.</p> <p>Furthermore, the large</p>

<p><i>1. In addition to margin requirements, a CCP should maintain sufficient available financial resources to cover potential residual losses that exceed the losses to be covered by margin requirements. For this purpose, the CCP should develop scenarios of extreme but plausible market conditions and conduct stress tests accordingly [...]</i></p> <p><i>2. Although a CCP's financial resources can take a variety of forms, for purposes of assessing observance of this recommendation, resources should be counted only if there is a high degree of assurance that a CCP can draw on them for the anticipated value and a CCP's rules do not permit them to be used to cover its normal operating losses or losses from other activities in which it is engaged.</i></p> <p><i>3. If any of the resources that are being relied upon are not immediately available to a CCP, it should obtain credit lines that are committed and subject only to presentment in order that it can borrow against those assets to meet its liquidity needs. The CCP's rules should ensure that the resources posted by a defaulter are used prior to other financial</i></p>		<p>exposure requirements).</p> <p>Annex III, Part 7, point 24, requirement to have stress-tests in place (applies to credit institutions which use the Internal Models Method for the calculation of counterparty credit risk).</p>	<p>exposures regime ensures that the amount of exposure to a single counterparty or connected party is not above certain limits.</p>
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<i>resources in covering losses.</i>			
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ESCB-CESR RCCP 6: Default Procedures	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>A CCP's default procedures should be clearly stated, and they should ensure that the CCP can take timely action to contain losses and liquidity pressures and to continue meeting its obligations. Key aspects of the default procedures should be publicly available and tested regularly.</i></p> <p><i>1. A CCP's default procedures should clearly state what constitutes a default and permit a CCP to promptly close out or effectively manage a defaulting participant's positions and to apply collateral or other resources. There should be clear procedures, or mechanisms other than those of the CCP, for handling customers' positions and margin. Default procedures should also permit a CCP to utilise promptly any financial resources that it maintains for covering losses and liquidity pressures resulting from the defaults.</i></p> <p><i>2. The legal framework applicable to a CCP should provide a high degree of assurance that its</i></p>	<p>Relevant to all custodian banks</p> <p>This recommendation is relevant to all custodian banks, especially those acting as CCPs.</p> <p>Some clearing intermediaries may be systemically important for a given market and therefore procedures should be in place to ensure the stability of their activities in case a default occurs.</p>	<p>This issue is addressed by:</p> <p>Directive 2006/48/EC, Title V, Chapter 2, Sections 3 and 5 (plus corresponding annexes).</p> <p>BCBS Guidelines on credit risk and liquidity risk.</p> <p>CEBS Guidelines on concentration risk, SRP, stress testing and liquidity risk.</p> <p>Directive 2004/39/EC, Article 13.</p> <p>Directive 2006/73/EC, Articles 16 to 19.</p>	<p>Recommendation indirectly met</p> <p>The CRD provisions provide indirect coverage of the issue addressed by the recommendation.</p> <p>CRD provisions under both Pillar I and Pillar II on credit risk (including concentration) and liquidity risk provide the necessary framework. Pillar II includes the use of stress testing that may prove to be helpful in this context.</p> <p>Additionally, MiFID provides for the necessary coverage regarding investors' protection.</p> <p>Although for some aspects insolvency laws are more relevant.</p> <p>Public disclosure of default procedures may eventually be addressed through Pillar III on risk management disclosures.</p>

<p><i>default procedures are enforceable, despite the insolvency of a participant. The national insolvency law should permit the identification and separate treatment of customer and proprietary assets.</i></p> <p><i>3. A CCP should analyse the effect which its default procedure may have on the market. A CCP's management should be well prepared to implement its default procedures in a flexible manner, and management should have internal plans for such an event, including communication with the operator of the market the CCP serves if that operator is a separate entity. The plans should be reviewed at least once a year and tested regularly.</i></p> <p><i>4. Key aspects of the default procedures should be publicly available.</i></p>			
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ESCB-CESR RCCP 7: Custody and Investment Risks	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>A CCP should hold assets in a manner whereby risk of loss or of delay in its access to them is minimised. Assets invested by a CCP should be held in instruments with minimal credit, market and</i></p>	<p>Relevant to all custodian banks</p> <p>The objective of the recommendation is twofold:</p>	<p>Legal risk is dealt with under the operational framework of the CRD (legal risk being part of operational risk) – Annex X of Directive 2006/48/EC. Investment risk is covered by</p>	<p>Recommendation met</p> <p>The recommendation is considered to be met even if the CRD does not have specific provisions for these aspects.</p>

<p><i>liquidity risks.</i></p> <p>Key issues:</p> <p>1. (...)a CCP should hold securities in custody at entities that employ accounting practices, safekeeping procedures, internal and external controls, insurance, and other compensation schemes that fully protect these securities; the legal framework also should be such that the securities are protected against the claims of a custodian's creditors. A CCP should have prompt access to securities when required. A CCP should monitor its custodians' financial condition, safeguarding procedures and operational capacity on an ongoing basis.</p> <p>2. Investments should be secured or they should be claims on high quality obligors. Investments should be capable of being liquidated quickly with little if any adverse price effect. A CCP should be prohibited from investing its capital or cash margins that the CCP intends to use for risk management purposes in its own securities or those of its parent company.</p> <p>3. In making investment decisions, a CCP should take into account its overall credit risk</p>	<p>(1) ensure that CCPs mitigate the custody risk to which they are exposed (i.e. due diligence on the selected custodians and assessment of the legal risk / legal certainty related to the availability of the securities in custody) and</p> <p>(2) ensure that CCPs have a sound and safe investment policy for their own assets.</p>	<p>both Pillar I and Pillar II of the CRD.</p>	
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<p><i>exposures to individual obligors, whether from cash investments or other relationships, and ensure that its overall credit risk exposure to any individual obligor remains within acceptable concentration limits.</i></p>			
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ESCB-CESR RCCP 8: Operational Risk	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>A CCP should identify sources of operational risk, monitor and regularly assess them. The CCP should minimise these risks through the development of appropriate systems, , and effective controls and procedures. Systems and related functions should be (i) reliable and secure, (ii) based on sound technical solutions, (iii) developed and maintained in accordance with proven procedures and (iv) have adequate, scalable capacity. The CCP should have appropriate business continuity and disaster recovery plans that allow for timely recovery of operations and fulfilment of a CCP's obligations. Systems should be subject to frequent and independent audits.</i></p> <p>Key issues:</p> <p>1. A CCP should actively identify,</p>	<p>Relevant to all custodian banks</p>	<p>-</p>	<p>Recommendation met</p> <p>See RSSS 11, as the provisions are equivalent.</p>

<p><i>monitor, assess and minimise sources of operational risk and should establish clear policies and procedures to address those risks, including risks from those operations that are outsourced to third parties, or from its other activities.</i></p> <p><i>2. Operational risk policies and procedures should be clearly defined, frequently reassessed and updated and tested to remain current. The responsibilities of the relevant governance bodies and senior management should be clearly established. There should be adequate management controls and sufficient (and sufficiently well-qualified) personnel to ensure that procedures are implemented accordingly. Information systems should be subject to periodic independent auditing.</i></p> <p><i>3. A CCP should have a business continuity and disaster recovery plan that addresses events posing a significant risk of disrupting operations including its reliance on third parties and the plan should allow for timely resumption of critical operations. This means that the CCP can meet its obligations on time. Contingency plans should, as a minimum, provide for the</i></p>			
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recovery of all transactions at the time of the disruption to allow systems to continue to operate with certainty. A second site should be set-up in order to meet these obligations. Business continuity and disaster recovery plans should be regularly reviewed, tested on a regular basis and after modifications to the system and tested with participants. Appropriate adjustments should be made to plans based on the results of such exercises. Adequate crisis management structures, including formal procedures, alternative means of communication and contact lists (both at local and cross-border level) should be available.

4. All key systems should be reliable, secure, and able to handle volume under stress conditions.

5. CCPs should only outsource settlement operations or functions to third parties after the approval of the relevant competent authorities, if it is required by regulation. If it is not required, they should at least notify in advance the relevant competent authorities, and should ensure that the external providers meet the relevant recommendations.

<p><i>The relevant outsourcing entities should have the power to require adaptation of the outsourcing measures.</i></p>			
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ESCB-CESR RCCP 9: Money Settlements	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>A CCP should employ money settlement arrangements that eliminate or strictly limit credit and liquidity risks. If central bank money is not used, steps must be taken to strictly limit cash settlement risks, that is, credit and liquidity risks stemming from the use of banks by a CCP to effect money settlements with its participants. Funds transfers to a CCP should be final when effected and rely on efficient and safe payment systems.</i></p> <p>Key issues:</p> <p><i>1. A CCP uses the central bank model or it uses the private agent model and takes additional steps (see key issue 3) to limit the probability of a settlement agent's failure and limit the potential losses in the event of such a failure.</i></p> <p><i>2. Funds transfers to a CCP should be final when effected. A</i></p>	<p>Relevant to all custodian banks</p>	<p>-</p>	<p>Recommendation partially met</p> <p>See RSSS 10 (and RSSS 12), as the provisions are equivalent.</p> <p>The recommendation is partially met, as RSSS 10 is only partially met.</p> <p>The Recommendation also addresses issues of RSSS 12 which were considered to be met.</p>

<p><i>CCP should routinely confirm that funds transfers have been effected as and when required by its agreements with its settlement agent(s). The legal, regulatory and contractual framework of the CCP should clearly define the moment at which the CCP' and clearing participants' obligations are extinguished. The payment system used by a CCP should be safe and sound, and should observe the Core Principles for Systemically Important Payments Systems (CPSIPS).</i></p> <p><i>3. A CCP should establish and monitor adherence to strict criteria for private settlement agents that address their creditworthiness, access to liquidity, and operational reliability in order to ensure that only regulated financial institutions with robust legal, financial (creditworthiness, access to liquidity) and technical capacity are used as settlement agents. The adherence to the criteria should be monitored both on an initial and an ongoing basis. A CCP should closely monitor the distribution of its exposures among its settlement agents, and assess its potential losses and liquidity pressures in the event that the agents with the largest share of settlements were to fail.</i></p>			
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<p><i>A CCP should also monitor liquidity risks that may stem from the use of several currencies or assets for payment activities.</i></p> <p><i>4. When a multi-tiered system is used for payment activities, a CCP should define criteria in terms of creditworthiness, access to liquidity and operational reliability that settlement banks should meet. A CCP should monitor the concentration of payment flows between settlement banks and assess its potential losses and liquidity pressure if the settlement bank with the largest share of settlement defaults.</i></p>			
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ESCB-CESR RCCP 10: Physical Deliveries	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>A CCP should clearly state its obligations with respect to physical deliveries. The risks from these obligations should be identified and managed.</i></p> <p>Key issues</p> <p><i>1. A CCP's rules should clearly state its obligations with respect to deliveries of physical instruments, including whether it has an obligation to make or receive delivery of a physical</i></p>	<p>Relevant only to custodian banks undertaking CCP-like activities</p> <p>In dealing with physical deliveries, the recommendation puts an additional obligation on the CCP. Where the custodian bank assumes the role of the CCP, this recommendation is relevant.</p> <p>For custodian banks that only</p>	<p>The CRD does not specifically cover this point, as the common settlement that is performed by credit institutions is not physical.</p>	<p>Recommendation not met</p> <p>Physical deliveries are very specific cases and include commodities. Therefore, it requires dedicated procedures - not restricted to credit or liquidity risk management - to be implemented for which the CRD does not provide any guidance. Therefore, the recommendation is considered not to be met.</p>

<p><i>instrument or whether it indemnifies participants for losses incurred in the delivery process.</i></p> <p><i>2. If a CCP has an obligation to make or receive deliveries of physical instruments, it should eliminate principal risk through the use of a DVP mechanism. If the settlement systems used by the CCP offer DVP but do not offer simultaneous booking of the DVP and RVP leg, a CCP should take additional steps to mitigate replacement cost risk. Also, if no DVP mechanism is available, a CCP should take other steps to mitigate principal risk. Liquidity risk must be managed by a CCP whether or not a DVP mechanism is available.</i></p> <p><i>3. If a CCP has obligations to make or receive deliveries of physical instruments, it should take steps to identify and mitigate all the money settlement, liquidity, storage and delivery (other than principal) risks to which it is exposed in the delivery process for the physical instruments</i></p>	<p>act as intermediaries, the counterparty will assume the risk deriving from the settlement and not the custodian bank.</p>		
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ESCB-CESR RCCP 11: Risks in Links between CCPs	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
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<p><i>CCPs that establish links either cross-border or domestically to clear trades should evaluate the potential sources of risks that can arise from the linked CCP and from the link itself. It should ensure that the risks are managed prudently on an ongoing basis. There should be a framework for co-operation and co-ordination between the relevant regulators and overseers.</i></p> <p>Key issues:</p> <p><i>1. CCPs should design links or interoperable systems in such a way that risks are minimised or contained. Before entering into a link relationship with another CCP or when significant changes occur in an existing link, a CCP should evaluate the potential sources of risks arising from the linked CCP and from the link. The initial risk assessment of the linked CCP should include sufficient understanding of the entirety of the other CCP’s risk arrangements, covering any other link arrangements. The risk assessment should be kept updated. The resulting arrangements should be designed such that risks are mitigated and the CCP remains able to observe the other recommendations</i></p>	<p>Relevant only to custodian banks undertaking CCP-like activities</p>		<p>Recommendation met</p> <p>The CRD requires capital to be held against credit exposures. A link between a custodian bank acting as a CCP and another CCP can be considered as a net exposure and as such would attract a capital charge. Such links would also need monitoring and be subject to home/host cooperation where such links are established cross-border. It is thus concluded that this recommendation is sufficiently covered under the risk management and supervisory framework of the CRD.</p>
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contained in this report.

2. Potential sources of operational, credit, liquidity and settlement risks to a CCP arising from a link should be effectively monitored and managed on an ongoing basis. In particular, risks should be covered by adequate resources and contagion risks should be mitigated.

3. The national laws and contractual rules governing the linked systems, and governing the link itself, should support the design of the link and provide adequate protection to both CCPs in the operation of the link. In particular, regulation and contractual rules should be designed such that no CCP is exposed to unexpected obligations or distortions of rights/obligations vis-à-vis the other one. Potential conflicts of laws and rules between the jurisdictions of CCPs should be identified and addressed.

4. For the purposes of regulation and oversight of the link, there should be a framework for cooperation and co-ordination between the relevant regulatory and oversight authorities, including provisions on information sharing and the

<i>division of responsibilities in the event of any need for regulatory action.</i>			
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ESCB-CESR RCCP 12: Efficiency	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<i>While maintaining safe and secure operations, CCPs should be efficient in meeting the requirements of participants.</i>	Not relevant	-	See RSSS 15, as the provisions are equivalent.

ESCB-CESR RCCP 13: Governance	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>Governance arrangements for a CCP should be clear and transparent to fulfil public interest requirements and to support the objectives of owners and participants. In particular, they should promote the effectiveness of a CCP's risk management procedures.</i></p> <p>Key issues:</p> <p><i>1. Governance arrangements should be clearly specified and publicly available.</i></p> <p><i>2. There should be a clear separation between the reporting lines for risk management and</i></p>	Relevant to all custodian banks	-	<p>Recommendation met</p> <p>See RSSS 13, as the provisions are equivalent.</p> <p>But, being aware that when a bank is acting as CCP, the credit risk that would otherwise be supported by its clients is transferred to it, as it appears as the counterparty of both clients.</p>

<p><i>those for other operations of a CCP.</i></p> <p><i>3. Management and the Board of Directors ("the Board") should have the appropriate skills and incentives to achieve a CCP's objectives, particularly delivering sound risk management and meeting related public interest requirements. Management and the Board should be fully accountable for their performance. The Board should contain suitable expertise and take into account all relevant interests.</i></p> <p><i>4. Objectives, those principally responsible for achieving them and the extent to which they have been met, should be disclosed to owners, participants (including applicants for participation) and public authorities.</i></p> <p><i>5. Governance arrangements should include the identification of conflicts of interest and should use resolution procedures whenever there is a possibility of such conflicts occurring.</i></p>			
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ESCB-CESR RCCP 14: Transparency	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
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<p><i>A CCP should provide market participants with sufficient information for them to identify and evaluate accurately the risks and costs associated with using its services.</i></p> <p>Key issues:</p> <p><i>1. A CCP should provide market participants with sufficient information to evaluate the risks and costs of using its services. The information should include the main statistics and, where relevant, the balance sheet of the system's operator. A CCP should publicly and clearly disclose its risk exposure policy and risk management methodology.</i></p> <p><i>2. Information should be accessible, at least through the internet. Information should be available in a language commonly used in financial markets as well as in at least one of the domestic languages.</i></p> <p><i>3. The accuracy and completeness of disclosures should be reviewed periodically by a CCP and at least once a year or when major changes occur.</i></p>	<p>Relevant to all custodian banks</p>	<p>-</p>	<p>Recommendation met.</p> <p>See RSSS 17, as the provisions are equivalent.</p>
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ESCB-CESR RCCP 15: Regulation, Supervision and Oversight	Relevance to custodian banks	CRD and/or other provisions	Outcome of the 'mapping'
<p><i>A CCP should be subject to transparent, effective and consistent regulation, supervision and oversight. In both a national and a cross borders context, central banks and securities regulators should cooperate with each other and with other relevant authorities regarding the CCP. Such cooperation should also ensure a consistent implementation of the recommendations.</i></p> <p>Key issues:</p> <p><i>1. The CCP should be subject to transparent, effective and consistent regulation, supervision and oversight. Securities regulators (including, in this context, banking supervisors where they have similar responsibilities and regulatory authority for CCPs) and central banks should have the ability and the resources to carry out their regulation, supervision and oversight responsibilities effectively.</i></p> <p><i>2. Securities regulators and central banks should clearly define and publicly disclose their</i></p>	<p>Relevant to all custodian banks</p>	<p>-</p>	<p>Recommendation met.</p> <p>See RSSS 18, as the provisions are equivalent.</p>

<p><i>objectives, their roles and key aspects of major policies for CCPs.</i></p> <p><i>3. To ensure transparent, consistent and effective regulation, supervision and oversight, different forms of cooperation amongst relevant authorities may be required: day to day cooperation of relevant authorities of a CCP, both in national and cross-border context, and the cooperation of central banks and regulators to ensure the consistent implementation of the recommendation and to achieve a level playing field for CCPs in the European Union.</i></p> <p><i>4. To enable them to carry out their activities, securities regulators and central banks should require CCPs to provide information necessary for regulation, supervision and oversight in a timely manner, including information on operations that have been outsourced to third parties or where the CCP proposes to undertake new activities.</i></p> <p><i>5. Securities regulators, central banks and other relevant authorities should cooperate with one another, both nationally and</i></p>			
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<i>in a cross border context, to achieve the safe and efficient operation of CCPs and links between CCPs.</i>			
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