MONTE TITOLI
GRUPPO BORSA ITALIANA

MONTE TITOLI RESPONSE TO THE ESCB-CESR CONSULTATION PAPER

PART 1: RECOMMENDATIONS FOR SECURITIES SETTLEMENT SYSTEMS

GENERAL COMMENTS

We welcome the resumption of the work on the recommendations that we deem a useful mean to promote efficiency and soundness of the post-trading sector in Europe and we would like to express our particular appreciation for some of the choices made in laying out the current version of the text:

- the change in the nature of the statements from standards into recommendations and the consequent choice of the public authorities as addressees, in line with their non-binding nature and with the original approach adopted with the CPSS-IOSCO Recommendations for Securities Settlement Systems;

- the adoption of the original text of the above-mentioned CPSS-IOSCO work in many of the recommendations, consistent with the declared aim of the initial work conducted in 2003 to adapt those recommendations to the European environment;

Moreover, we can understand and share the idea to exclude global custodians from the scope of application of the recommendations to avoid overlapping with other measures expressly addressed to them. At the same time we would like to point out that, due to the increasing internationalisation in this sector also after the adoption of the Markets in Financial Instruments Directive (MiFID), global custodians are increasingly acquiring a systemic relevance. Therefore, we would suggest that and European authorities carry out a continuous monitoring to avoid that disruptions and operational problems within global custodians extend to third parties and imply systemic risks.

TERMINOLOGY

We have the impression that the terms (I)CSDs and SSSs are sometimes used inconsistently throughout the draft text. Most likely this depends on the fact that the original CPSS/IOSCO Recommendations were addressed exclusively to SSSs and only in a second step their application was extended to all CSDs activities.

Paragraph 45 of the Introduction underlines that SSSs are part of the systems carried out by the CSDs. Coherently when the text makes reference to CSDs the relating recommendation should be also applied to the securities settlement platform run by the same CSDs. Nevertheless, it does not appear clear what happen for recommendations

Monte Titoli S.p.A.
Sede Sociale e Direzione Generale: Via Mantegna, 6 20154 Milano Tel. +39 02 33635.1 Fax +39 02 33635.333 Telex 313470 Titoli I www.montetitoli.it
Capitale Sociale € 16.000.000 i.v. Registro delle Imprese n. 03638780159 Tribunale di Milano R.E.A. n. 980806 Milano Codice Fiscale e Partita I.V.A. 03638780159
Società sottoposta all'attività di direzione e coordinamento di Borsa Italiana S.p.A.

mentioning specifically the SSSs. This is for instance the case for Recommendation 15: should these recommendation be applied to the settlement systems or should it also refer to the other systems (mainly the custody ones) run by the CSDs? The possibility of this interpretation of the text may suggest a re-thinking in the use of the terminology all over the paper to be sure about the scope of the single recommendations.

GLOSSARY

As in the previous version of the ESCB-CESR work on post-trading, the document is accompanied by a glossary clarifying the meaning to be assigned to the terms used in the main text. In the light of the ECB initiative to develop and adopt a glossary of all the terms relating to the technical aspects of payment, clearing and settlement systems in the EU, we wonder if it is possible to make reference to it also for the purposes of the ESCB-CESR recommendations. As an alternative we would recommend that consistency between the two is granted for the sake of clarity and to avoid confusion on the described activities.

RECOMMENDATION 1: LEGAL FRAMEWORK

As a general comment, we would like to point out that the legal framework within which the CSDs/SSSs operate is mostly independent from the CSDs/SSSs themselves. Entities operate in accordance within a legal environment they are not able to modify. This should be taken into account by the public authorities when evaluating the legal assurance of the legal framework for the purposes of the assignation of the assessment category.

Moreover, Paragraph C8 seems to require that the legal framework of a securities settlement system govern the "proprietary aspects of securities held on a participant's account with a system". We note that, as a general rule, securities held on the accounts of a CSD/SSS give to the account's holder the entitlement to exercise the rights of securities and not properties rights. We remind that works and analyses have been carried out by, among others, the Hague Securities Convention and the Unidroit but that a final solution remains to be reached. Therefore, we would suggest to reword the sentence to make a general reference to "the rights of securities held on a participant's account with the system".

Besides, Paragraph C4 lists sixteen subjects on which the CSD should provide information to market participants. The text seems to require such disclosure where relevant. However there is no suggestion on how the CSD should evaluate such a relevance nor on the method for the provision of such information: is the public availability (on the web site) of the legal text applicable to the CSD sufficient or is the adoption of a specific document envisaged to fulfil the requirement?

Finally, the same Paragraph C4 requires this information be "supported where appropriate by an internal or external analysis or opinion". We would like to stress the fact that in many countries all the activities performed by a CSD are subject to an authorisation regime and to a supervisory activity carried out on a continuous basis. We would suggest that in carrying out the assessment the authorities take in due consideration the overall supervisory regime and evaluate if the provision of internal or external analyses or opinions may therefore be redundant and unneeded.

RECOMMENDATION 3: SETTLEMENT CYCLES AND OPERATING TIMES

The recommendation suggests to adopt rolling settlement mechanisms "in all securities markets". Nevertheless, we note that some markets might require the adoption of accounting mechanisms to function in a sound and order manner. For instance in Italy this is the case for takeovers bids whose execution can be performed on the exchange. In this case the accounting settlement system seems the best way to manage it. Moreover, the adoption of accounting systems instead of rolling ones may be appropriate for some secondary markets dealing with illiquid financial instruments. We would then recommend the authorities evaluate carefully the scope of the extension of the rolling settlement obligation and the complete abolition of accounting settlement system.

RECOMMENDATION 8: TIMING OF SETTLEMENT FINALITY

Paragraphs B4 and C6 of the Recommendation recognise the possibility for a "unilateral revocation of unsettled transfers instructions late in the settlement day".

This provision appears to be not in line with Art. 5 of the "Directive 98/26/EC on settlement finality in payment and securities settlement systems which requires that "a transfer order may not be revoked by a participant in a system, nor by a third party, from the moment defined by the rules of that system". Therefore, according to our understanding a transfer order should be not revoked on a unilateral basis when final even if in a fail status. We would then suggest to drop the words "late in the settlement day" in the above mentioned text.

RECOMMENDATION 9: CSD RISK CONTROLS TO ADDRESS PARTICIPANTS' FAILURES TO SETTLE

The text urges the institution of risk control measures (collateral requirements and limits) for those CSDs extending intraday credit to their participants and for CSDs operating net settlement systems. We note that providing intraday credit facilities and carrying out net settlement systems represent very different activities, which entail

diverse risks and require the adoption of specified and appropriate containment measures. In particular, while collateral requirements and limits may be adequate to keep down credit exposure, other measures may be more suitable to address the risks connected with net settlement systems, such as: adoption of sophisticated algorithms; introduction of partial deliveries; use of optimisation mechanisms; implementation of solutions to identify the original gross contracts which caused the fails.

We would then prefer that the authorities address the need to establish collateral requirements and limits only to those CSDs providing intraday credit to their participants. This should be reflected also in the text of the assessment methodology (section E2, Part 1 "Observed" point a) where those measures are addressed in general to CSDs with no distinction between those extending credit to their participants and those operating net settlement systems.

RECOMMENDATION 19: RISKS IN CROSS-SYSTEM LINKS OR INTEROPERABLE SYSTEMS

Point 2 of the Key issues seems to suggest that all links between CSDs should ensure the compliance with the delivery versus payment (DVP) principle.

Nevertheless, the implementation of DVP links represents a quite expensive investment that in some case might be not justified from a risk point of view due to the marginal number of transactions which are carried out through those links. Besides, when deciding whether updating and implementing a DVP link, business evaluations should be taken in due consideration. Moreover, we note that this remark is already expressed in the text of the assessment methodology (Paragraph 7 of the Explanatory note to the assessment). We would suggest to include Paragraph 7 of the Assessment methodology also within the text of the Explanatory Memorandum of the Recommendation.

Furthermore, we notice that Paragraph 4 of the Explanatory Memorandum envisages the evaluation of the financial integrity of the CSD with which there is an intention to establish a link. We believe that this requirement may significantly increase the cost for setting up a link and therefore hampering the adoption of interoperable solutions between CSDs. Moreover, we have the impression that in many cases this requirement may result not justify from the nature and the type of risks involved as the major part of CSDs only take operational risks. Again, many CSDs, in particular the ones without a banking status, may not have the adequate skills and resources to carry out this type of evaluation. Finally, we note that MiFID assigns national authorities with the task to verify any impact in terms of risk due to the implementation of interoperable solutions with foreign post-trading service providers. Therefore, it might be the risk that the same evaluation activity be performed both by the CSDs and the relating public authorities.

For the above, we would suggest to delete the reference to the financial integrity contained in the first sentence of Paragraph 4 of the Explanatory Memorandum.