

THE ASSOCIATION OF GLOBAL CUSTODIANS

THE BANK OF NEW YORK MELLON
BROWN BROTHERS HARRIMAN
CITIBANK, N.A.
DEUTSCHE BANK
HSBC SECURITIES SERVICES
J.P. MORGAN
NORTHERN TRUST
RBC DEXIA INVESTOR SERVICES
SKANDINAVISKA ENSKILDA BANKEN
STANDARD CHARTERED BANK
STATE STREET BANK AND TRUST COMPANY

COUNSEL AND SECRETARIAT TO THE ASSOCIATION:

BAKER & MCKENZIE LLP

EUROPE
ATT: ARUN SRIVASTAVA
100 NEW BRIDGE STREET
LONDON EC4V 6JA, ENGLAND
INT'L TEL: 44 20 7919 1000

GLOBAL
ATT: ROBIN TRUESDALE
815 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20006
TEL: 202 452 7000
FAX: 202 452 7074

WWW.THEAGC.COM

7 March 2011

Via electronic submission: markt-consultation-csd@ec.europa.eu

Patrick Pearson
DG Internal Markets and Services
Head of Unit G.2 Financial Markets Infrastructure
European Commission
Rue de Spa, 2
B-1000 Brussels
Belgium

**Re: Public Consultation – Central Securities Depositories and the
Harmonization of Certain Aspects of Securities Settlement in the
European Union**

Dear Sir:

We write on behalf of the members of the Association of Global Custodians¹ to set out members' views concerning the Consultation Document ("Consultation") issued by the European Commission ("Commission") on the establishment of a regulatory framework for Central Securities Depositories ("CSD") and the harmonization of certain aspects of securities settlement in the European Union ("EU"). We appreciate the opportunity to convey members' views. Given that most Association members have

¹ The Association is an informal group of 11 member banks that provide securities safekeeping and asset-servicing functions to cross-border institutional investors worldwide. Members provide custody-related services to most types of institutional investors, including investment funds, pension funds, and insurance companies. Members' clients include European-based funds and investors, and members play a substantial role in European markets. Members participate in all European CSDs either directly or through subcustodians and as such have considerable interest in safe, effective and efficient CSD operations.

THE ASSOCIATION OF GLOBAL CUSTODIANS

Patrick Pearson

7 March 2011

Page 2

submitted their own comments on the Consultation, or will do so soon, this letter focuses the Association's comments, at a high level, on core issues of paramount concern to global custodians.

Key objective of CSD Legislation – Systemic safety and soundness.

The Association welcomes the Commission's recognition of CSDs as systemically important financial market infrastructures that provide critical and exclusive centralized services to professional market participants. CSDs provide an indispensable infrastructure function in the post-trading market – a service function that intermediaries must use; and for that reason *the Association fully supports efforts to ensure the appropriate regulation and supervision of CSDs.* Moreover, members believe appropriate regulation of CSDs will become increasingly important as the operational landscape for infrastructure utilities across Europe evolves. Indeed, the evident move by CSDs today to expand the scope of their servicing strategies is driven largely by the coming T2S reality where traditional, core CSD settlement functionalities will be altered considerably as a business model.

While the Commission's attention to the post-trading, infrastructure-utility function of CSDs is welcome, members strongly encourage the Commission not to overlook the essential role of CSDs in ensuring the safe and efficient functioning of the modern marketplace. In this regard, the potential systemic risk involved when CSDs engage in commercial activities beyond their core infrastructure function should not be underestimated. In members' view, the overriding principle in CSD regulatory legislation should be to ensure that CSDs, as systemically important market infrastructures, do not underwrite risks which could jeopardize their ability to provide core services, whether in a routine setting or in stressed market scenarios. Thus, members believe *the main objective of CSD legislation should be to ensure the safety and soundness of the post-trading environment.*

Ring-fencing of Systemically Important CSD Functions.

A key tool to achieving this safety-and-soundness objective is *mandatory segregation, or "ring-fencing", of systemically important services provided by CSDs,* including notably the ICSDs. Because ICSDs perform critical market functions as essential facilities, their expansion into ancillary lines of business can pose risks to core utility services or systemic integrity. As a general principle, members believe that ICSD expansion into ancillary commercial services must be accompanied by effective functional separation of those services from core CSD services, coupled with careful

THE ASSOCIATION OF GLOBAL CUSTODIANS

Patrick Pearson

7 March 2011

Page 3

regulatory monitoring to ensure that any such expansion takes place in a safe and sound manner and does not introduce systemic or concentration risk into market infrastructure or operate on terms and conditions that distort competition. Competition could be distorted, for example, by enabling arbitrage between regulations or prevailing practices that apply to central infrastructure functions as compared to those that apply to commercial market intermediaries.

Accordingly, the *CSD legislation should focus on the “core services” and “operational risk only” ancillary services provided by CSDs*, e.g., services that facilitate the processing of corporate actions, other services provided to issuers, and non-central safekeeping of financial instruments for the account of clients, when provided in central bank money. A second category of ancillary services -- *“non-operational risk” ancillary services*² -- e.g., provision of banking services, credit, collateral management, and securities lending services -- could significantly change the risk profile of the CSDs and hence increase systemic risk, and this category of potential services *should be subject to the ring-fence requirement that places those services in a suitably-capitalized, separate legal entity, effectively segregating that activity from the provision of core CSD services*. This separation would help to ensure the integrity of CSD services even in the case of financial insolvency of the entity providing the “non-operational risk” ancillary services.³

Appropriate Functional Regulation of CSD-related Entities’ “Non-operational Risk” Activities.

As a corollary, *CSD affiliates that undertake such ancillary “non-operational risk” activities should be subject to the same set of prudential regulations as those faced by providers of similar intermediary services*. As such, members would anticipate that such CSD affiliates would be subject not just to the Markets in Financial Instruments

² The Consultation also refers to these “non-operational risk” ancillary services as “banking type services”.

³ In the United States, for example, the DTC’s core services are ring-fenced, as it offers settlement in central bank money only and does not provide risk-taking banking-type services. Significantly, that ring-fencing has not prevented the parent of that US CSD from being innovative, offering a wide range of different services via separate subsidiaries (like DTCC Deriv/SERV LLC, the Warehouse Trust Company, EuroCCP, DTCC Solutions LLC, and DTCC Loan/Serve LLCO) or joint ventures, like Omgeo and MarkitServ.

THE ASSOCIATION OF GLOBAL CUSTODIANS

Patrick Pearson

7 March 2011

Page 4

Directive and the Securities Law Directive, as proposed by the Commission, but also to the full range of the relevant European bodies of law, including the Alternative Investment Fund Managers Directive, the Directive on Undertakings for Collective Investments in Transferable Securities ("UCITS") and the Investor Compensation Scheme Directive.

Due Attention to Post-trading Innovation.

At the same time, the Association believes it important that the new legislative framework not preclude innovation in the post-trading space. Innovation tends to advance market access and efficiency opportunities for market participants. Members therefore believe the competitiveness and resilience of the EU market infrastructure could be enhanced by structuring the legislation to promote or facilitate innovation while also ensuring investor protection and market stability. We therefore recommend that the Commission *work toward harmonized regulation for CSDs that targets identified risks and inefficiencies without stifling the potential for service innovations that may be beneficial to the market.*

Promotion of Competition Among CSDs: Level Playing Field and Harmonization Principles.

Finally, CSD regulation should *promote a level competitive playing field for market infrastructure activities.* A level playing field among CSDs will serve the interest of European markets over time and should encourage and facilitate needed harmonization. As a related point, the Association encourages the Commission to coordinate its work on this legislation with regulatory standards currently in existence for CSDs outside of Europe. Indeed, effective alignment with other regulatory frameworks, including those in place in the United States, is important to global custodians, as it increases global investors' ability to access and participate in EU financial markets fluidly.

*

*

*

*

*

THE ASSOCIATION OF GLOBAL CUSTODIANS


Patrick Pearson

7 March 2011

Page 5

The Association appreciates the opportunity to provide you with members' views on the foregoing matters, which are of significant interest and concern to global custodians. Members would welcome an opportunity to discuss these views with you further. For additional information or to initiate such as discussion, please contact the undersigned.

Sincerely, yours,

A handwritten signature in black ink, appearing to read "Dan W. Schneider". The signature is fluid and cursive, with a long horizontal stroke at the end.

Dan W. Schneider
Baker & McKenzie LLP
Counsel to the Association