

## Assessment of the ESES CSDs/SSSs against the CPMI-IOSCO Principles for FMIs

The ESES CSDs/SSSs (central securities depositories / securities settlement systems) comprise Euroclear Belgium (EBE), Euroclear France (EF) and Euroclear Netherlands (ENL), and belong to the Euroclear Group. Since 19 January 2009, the ESES CSDs operate an integrated settlement platform, the Euroclear Settlement of Euronext-zone Securities (ESES) platform.

The ESES CSDs/SSSs have been assessed against the 2012 CPMI-IOSCO Principles for Financial Market Infrastructures (FMIs), in as far as they are applicable to CSD or SSS. The assessment does not constitute a direct assessment of their direct holding company Euroclear SA (ESA). However, as ESA is both the parent company of the ESES CSDs/SSSs and their service provider, ESA is partially within the scope of the assessment. ESA is also the parent company of the other Euroclear Group entities (i.e. the CSDs in Finland, Sweden, the UK & Ireland and of the ICSD Euroclear Bank) but these (I)CSDs and their respective securities settlement systems are outside the scope of this assessment.

The assessment of ESES has been conducted jointly by the French, Dutch and Belgian securities commissions and central banks; i.e. the *Autorité de Marchés Financiers* (AMF), the *Banque de France* (BdF), the *Autoriteit Financiële Markten* (AFM), *De Nederlandsche Bank* (DNB), the *Financial Services and Markets Authority* (FSMA) and the *National Bank of Belgium* (NBB).<sup>1</sup> Nonetheless, the opinion on the compliance of each respective national ESES CSD/SSS with the CPMI-IOSCO Principles for FMIs is that of their respective central bank and/or securities commission that supervises and/or oversees that CSD/SSS, in accordance with its supervisory and oversight competency.

The assessment report was finalised in March 2015 on the basis of information available up to mid-2014, and in some specific cases – as regards the ESES CSDs' recovery plans - up until end October 2014. In the next sections; a high-level overview of the Belgian, Dutch and French settlement landscape is provided as well as the key findings of the assessment of the ESES CSDs against the CPMI-IOSCO Principles for FMIs.

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<sup>1</sup> EBE, EF and ENL are subject to the regulation and oversight of their respective national competent authorities. The competent Belgian, Dutch and French central banks and securities commissions signed a Memorandum of Understanding (MoU) in October 2009 that sets out principles for the co-ordination of their respective responsibilities for regulating and overseeing Euroclear SA (ESA), the parent company of the ESES CSD. This ESA MoU was also signed by the other central banks and securities regulators which regulate and oversee Euroclear entities in the UK, Sweden, and Finland. The ESA MoU was also, at the level of ESES, complemented in March 2010, when working arrangements were agreed between the ESES authorities on the co-operation and co-ordination of oversight and supervisory activities related to the ESES CSD / SSS.

## OVERVIEW OF THE BELGIAN, DUTCH AND FRENCH SETTLEMENT LANDSCAPE

The ESES platform settles both transactions executed on the Paris, Amsterdam and Brussels Euronext stock exchange cash markets, centrally cleared by the Paris-based LCH.Clearnet SA, and bilaterally concluded over-the-counter (OTC) trades, including fixed income transactions and repo trades.

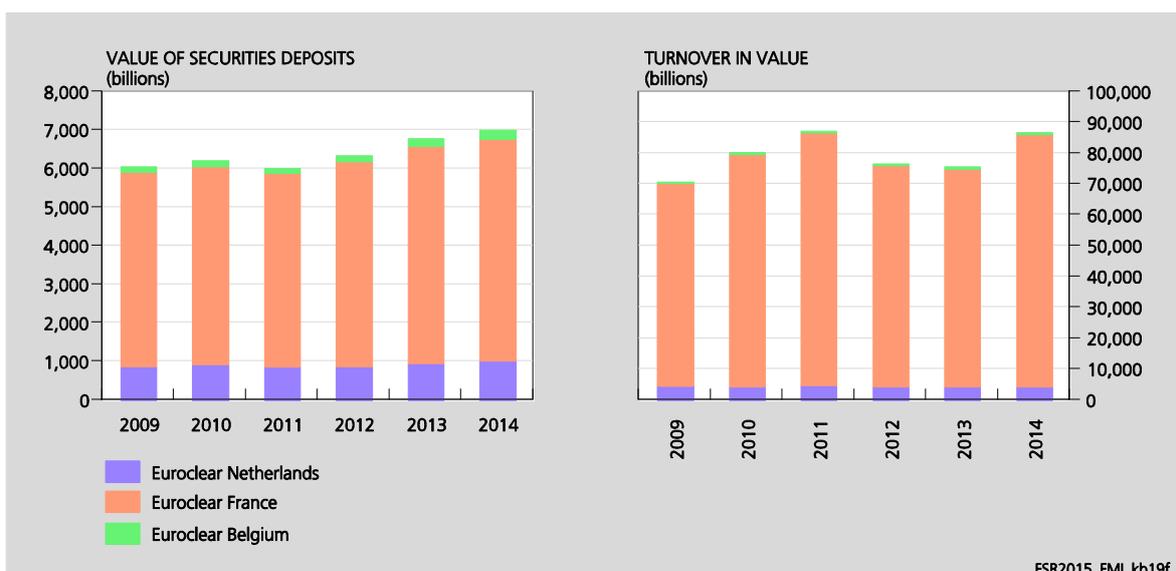
The ESES settlement system offers Delivery Versus Payment (DVP) book-entry settlement in central bank money (DVP model 1), providing real-time settlement. The transactions are settled in central bank money, on cash accounts legally held with the NBB, the BdF and DNB, and operated respectively by EBE, EF and ENL. For their settlement in central bank money, the ESES CSDs are linked with TARGET2, which is a real-time gross settlement (RTGS) system owned and operated by the Eurosystem.

The ESES CSDs also maintain direct and indirect (or, relayed) international links for the settlement of cross-border transactions in foreign securities. The majority of foreign securities are held with Euroclear France as an investor CSD, via relayed links through the ICSD Euroclear Bank. Moreover, each ESES CSD has a direct link with Euroclear Bank.

The core business services offered by the ESES CSDs/SSSs include settlement and custody services. EBE is the only ESES CSD/SSS that holds and settles primarily equities.

Chart 10 provides an overview of the value of securities deposits held in the ESES CSDs as well as their settlement turnover. . In 2014, the value of securities held in custody amounted to 22 billion EUR for Euroclear Belgium, 1 033 billion EUR for Euroclear Netherlands and 5 757 billion EUR for Euroclear France. The value of the settlement turnover amounted to 835.5 billion EUR for EBE, 4 366 billion EUR for ENL and 81 722 billion EUR for EF.

Relevant share of securities deposits and settlement turnover per ESES CSD



## SUMMARY ASSESSMENT

This section summarises the key findings of the detailed assessment of principles and sets out the recommendations to the ESES CSDs.

Summary of the results of the principle-by-principle assessment of observance	
Ratings summary for principles: ESES CSDs	
<i>Assessment category</i>	<i>Principles</i>
Observed	1, 2, 3, 4, 7, 8, 9, 10, 11, 12, 13, 15, 16, 17, 18, 21, 22,
Broadly observed	19, 20, 23
Partly observed	None
Not observed	None
Not applicable	5, 6, 14, 24

### **General organisation (Principles 1 to 3)**

**Principle 1 - Legal basis** - The ESES CSDs have a well-founded, clear, transparent, and enforceable legal basis for each material aspect of their activities in all relevant jurisdictions. However, in as far as the stipulation of the operational details of the contractual framework via Detailed Service Descriptions (DSDs) and Newsletters is concerned, it is not always clear for both the CSDs and the clients which constitute the binding rules, given that the Newsletters are not always precise on what DSD should be changed and how the DSD is changed, given that DSDs are not timely updated.

**Principle 2 - Governance** - The ESES CSDs' governance arrangements are deemed to be clear and transparent. The description of the governance arrangements is clear and they have been made available via the Euroclear website as well. The governance arrangements also clearly promote the safety and efficiency of the ESES CSDs through the Board objectives set. The objectives support the role of the ESES CSDs in the broader financial system and take into account public interest considerations and the objectives of relevant stakeholders.

**Principle 3 - Framework for the comprehensive management of risks** - The ESES CSDs have a sound risk-management framework in place for comprehensively managing legal, credit, liquidity, operational, and other risks. The ESES CSDs elaborated a recovery plan that is operational. However, this assessment does not include the compliance with the CPMI–IOSCO guidance on FMI recovery that was issued in October 2014. Euroclear should check the ESES CSDs' recovery plan on its compliance with this guidance.

### **Credit and liquidity risk management (Principles 4 to 7)**

**Principle 4 - Credit risk** - The ESES CSDs have a risk framework in place that includes credit exposure monitoring. However, since the ESES CSDs activities do not include any activity that generates credit exposure to their participants, apart from the monthly invoicing. Such a risk is deemed as being acceptable, since it relates only to revenues stemming from their activities.

The **Principle 5 - Collateral** and **Principle 6 – Margin** are not applicable as regards the ESES CSDs.

**Principle 7 - Liquidity risk** - The ESES CSDs are not directly exposed to liquidity risk stemming from their settlement activity. Liquid resources are held by each of the ESES entities to cover their general business risk. Throughout the operational day, participants are provided with reports and messages so that they can effectively manage their cash positions.

#### **Settlement (Principles 8 to 10)**

**Principle 8 - Settlement finality** - The ESES CSDs do provide clear and certain final settlement, either during the night batch that precedes the intraday settlement window or in real time in the course of the settlement day. While the legal soundness of the settlement finality rules is backed by legal opinions, the ESES CSDs should establish a formal policy for updating these legal opinions.

**Principle 9 - Money settlements** - The ESES CSDs do conduct their money settlements in central bank money. The ESES participants are able to use their single central bank cash account with their respective ESES country central bank to settle transactions of securities held in each ESES CSD.

**Principle 10 - Physical deliveries** – The ESES CSDs clearly state their obligations with respect to the delivery of physical instruments. The ESES CSDs country laws no longer allow the withdrawal of physical instruments. Further, the ESES CSDs identify, monitor, and manage the risks associated with holding physical paper or global note securities.

#### **Central securities depositories and exchange-of-value settlement systems (Principles 11 and 12)**

**Principle 11 - Central securities depositories** - The ESES CSDs have appropriate rules and procedures to ensure the integrity of securities issues and to minimize and manage the risks associated with the safekeeping and transfer of securities. While all securities are not yet dematerialized, new issuances are to be in book-entry form. Adequate controls prevent the unauthorized creation or deletion of securities, and the ESES settlement system prohibits debit balances in securities accounts. The rights of securities holders are safeguarded in the relevant jurisdictions.

**Principle 12 - Exchange-of-value settlement systems** - The ESES CSDs settle transactions that involve two linked obligations securities on a Delivery-versus-Payment. In that case, securities are exchanged against cash thereby eliminating principal risk.

#### **Default management (Principles 13 and 14)**

**Principle 13 - Participant-default rules and procedures** - The ESES CSDs have effective and clearly defined rules and procedures to manage participant insolvency procedures. While the participant insolvency procedures are updated regularly, the ESES CSDs should establish a formal policy for reviewing the rules and procedures related to the handling of a participant's insolvency. ESES does test the default procedures internally but not with its participants. The ESES CSDs should engage in testing and reviewing the default procedures with their participants.

**Principle 14 – Segregation and Portability** – is not applicable for CSD/SSS.

### **General business and operational risk management (Principles 15 to 17)**

**Principle 15 - General business risk** - The ESES CSDs identify, monitor and manage their general business risk. They hold sufficient liquid net assets to cover potential general business risks, including so as to ensure a recovery or an orderly winding down of the critical operations and services.

**Principle 16 - Custody and investment risks** – Participants’ assets are protected and are held with other (I)CSDs. Legal opinions do back the protection of the participants’ ownership rights on securities. The ESES CSDs’ investment policy as regards their own cash deposits is sound. The ESES CSDs safeguard their own assets and minimize the risk of loss and delay in access to these assets. Nonetheless, the ESES CSD should document and formalize that their cash deposits can be withdrawn on demand in case of need.

**Principle 17 - Operational risk** - The operational risk management framework, system setup and business continuity management framework of Euroclear are sound and adequate. The risk management framework allows the ESES CSD to identify the plausible sources of operational risk, both internal and external, and manage and mitigate their impact. The systems used ensure a sufficient level of security and operational reliability and have adequate, scalable capacity. The business continuity management framework allows for timely recovery of operations and fulfilment of the ESES CSDs’ obligations, including in the event of a wide-scale or major disruption.

### **Access (Principles 18 to 20)**

**Principle 18 - Access and participation requirements** - The ESES CSDs allow for a fair and open access to their services, based on reasonable risk-related participation requirements. All rules are stated clearly and publicly on the ESES CSDs’ website. The ESES participants’ admission criteria give the ESES CSDs unnecessary discretionary power to decide on additional conditions or requirements regarding technical and operational capability of a participant. The ESES CSDs should review this aspect of their contractual framework. Further, the sponsorship review should be executed on a more regular basis than every five years

**Principle 19 - Tiered participation arrangements** - The ESES CSDs have no formal tiered participation arrangements since they enter contractual relationship only with their direct participant and they monitor and manage risks at an aggregated level. Information about indirect participants that the ESES CSDs have available is dependent on the level of segregation that a direct participant has chosen for its clients assets. No contractual right is in place to gather, from the direct participant, basic information on tiered participation. There is no sufficient guarantee that the information available to the ESES CSDs is complete and correct, while the collection of information on tiered participation is useful to detect dependencies relevant to the sound and smooth functioning of the securities settlement system. The ESES CSDs should collect basic information about indirect participation and potential material dependencies between direct and indirect participants should be identified based on all available information.

**Principle 20 - FMI links** - ESES CSDs have established links with foreign (I)CSDs. Where they act as investor CSDs, these links are mostly relayed links via Euroclear Bank. While external legal opinions are available, the legal and operational risk reviews of the links where an ESES CSD acts as an investor CSD are not adequately documented by the ESES CSDs. The ESES CSDs should perform and document the risk reviews that are said to be performed before establishing a new link.

The ESES CSDs are responsible for selecting with due care the foreign CSDs with which they establish links as well as for identifying, monitoring and managing the risks of these links. Nevertheless, Euroclear Bank actually carries out much of this task, while no outsourcing

arrangement is in place between the ESES CSDs and Euroclear Bank. Where the diligences are outsourced to Euroclear Bank, the ESES CSDs should formalize this both for the direct links and the relayed links they hold. After formalization, the ESES CSDs should be able to get all relevant information derived from the outsourcing of activities.

### **Efficiency (Principles 21 and 22)**

**Principle 21 - Efficiency and effectiveness** - The ESES CSDs are efficient and effective in meeting the requirements of their participants and the markets they serve.

**Principle 22 - Communication procedures and standards** - The ESES CSDs use internationally accepted communication procedures and standards to facilitate settlement and recording. As other Euroclear group entities, they apply international ISO 15022 communication standards, procedures and recommendations. Further, automatic interaction to the ESES platform occurs via two channels, either EuroclearConnect for straight-through-processing applications or EuroclearConnect for screen based applications. The services offered via both of these channels are reachable through BT/Radianz and SWIFT.

### **Transparency (Principles 23 and 24)**

**Principle 23 - Disclosure of rules, key procedures, and market data** – The ESES CSDs adopt clear and comprehensive rules that are fully disclosed to the participants via their website. These include the ESES CSDs' contractual framework, consisting of the ESES CSDs' Terms and Conditions, Operating Manuals and Detailed Service Descriptions. The ESES CSDs consult with clients on changes that may have a material effect on them. The ESES CSDs also disclose on their website the system's design and operations, as well as the CSD's and participant's rights and obligations, and the fees for the services provided. ESES participants can assess the risks and costs they incur by participating in ESES. In as far as the stipulation of the operational details of the contractual framework via Detailed Service Descriptions (DSDs) and Newsletters is concerned, it is not always clear for both the CSDs and the clients which constitute the binding rules. When updating their contractual framework, the ESES CSDs should ensure, via adequate references, that the Newsletters and the Detailed Service Descriptions are always coherent, in order for all the information disclosed to clients to be fully transparent, understandable, and unambiguous.

**Principle 24** is not applicable for CSD/SSS.

## List Recommendations for the ESES CSDs/SSSs

<b>Prioritized list of recommendations for the ESES CSDs/SSSs</b>			
<b><i>Principle</i></b>	<b><i>Issue of concern or other gap or shortcoming</i></b>	<b><i>Recommended actions and comments</i></b>	<b><i>Time frame for addressing recommended action</i></b>
19	<p>There is no guarantee that the information available to the ESES CSDs about indirect participation is complete and correct. The collection of information on tiered participation remains useful to detect dependencies relevant to the sound and smooth functioning of the securities settlement system.</p>	<p>Basic information about indirect participation should be gathered and potential material dependencies between direct and indirect participants should be identified based on all available information.</p>	By end 2015
20	<p>While external legal opinions are available, the legal and operational risk review of the links where an ESES CSD acts as an investor CSD is not adequately documented by the ESES CSDs.</p> <p>The ESES CSDs are responsible for selecting with due care the foreign CSDs with which they establish links as well as for identifying, monitoring and managing the risks of these links. Nevertheless, Euroclear Bank actually carries out much of this task, while no outsourcing arrangement is in place between the ESES CSDs and Euroclear Bank.</p>	<p>The ESES CSDs should perform and document the risk reviews of the links.</p> <p>As some of the diligences are outsourced to Euroclear Bank, the ESES CSDs should formalize this both for the direct links and the relayed links they hold. After formalization, the ESES CSDs should be able to get all relevant information derived from the outsourcing of activities.</p>	Before the migration of the ESES CSDs to the Target2Securities platform
23, 1	<p>In as far as the stipulation of the operational details of the contractual framework via Detailed Service Descriptions (DSDs) and Newsletters is concerned, it is not always clear for both the CSDs and the clients which constitute the binding rules, given that the Newsletters are not always precise on what DSD should be changed and how the DSD is changed, given that DSDs are not timely updated</p>	<p>When updating their contractual framework, the ESES CSDs should ensure, via adequate references, that the Newsletters and the Detailed Service Descriptions are always coherent, in order for all the information disclosed to clients to be fully transparent, understandable, and unambiguous.</p>	<p>By the end of Q2, 2015.</p> <p>The ESES CSDs started to include precise references to the DSD in the newsletters that update the contractual framework.</p>

3, 15	This assessment does not include the compliance with the CPMI–IOSCO guidance. This point will be followed-up further in 2015 by the ESES authorities.	Euroclear should check the ESES CSDs' recovery plan on its compliance with the CPMI-IOSCO guidance on recovery of FMI. Among other things, Euroclear should verify if each of its recovery tools exhibits the five criteria of appropriateness to the greatest extent possible.	By the end of 2015
8, 1	No formal policy for updating the legal opinions on settlement finality is in place.  Specifically, the legal opinion covering EBE as regards the nature and governing law of entitlements in securities, liability of the SSS and finality, has been delivered on 4 September 2008.	The ESES CSDs should formalize their policy for updating the legal opinions relevant for their sound and adequate operation. Even if no material changes seem to have occurred after this period, it is apt to provide regular updates.	By the end of 2015
13	Although the participant insolvency procedures are updated regularly, there is no formal policy determining the review of the internal plans.  ESES does not test and review the default procedures with its participants. Testing the procedures raises the awareness and may detect possible shortcomings in the procedures.	The ESES CSDs should formalize the policy they have in place for reviewing the internal plans and governance arrangements related to the handling of the insolvency of a participant.  The ESES CSDs should engage in testing and reviewing the default procedures with their participants.	By the end of 2015
16	The investment policy as regards cash deposits is not always clearly articulated.	The ESES CSDs should further document how the investment policy will be safeguarded, in particular as regards their ability to withdraw cash deposits on demand when this would be needed.	By the end of 2015
18	The ESES participants' admission criteria give the CSDs discretionary power to decide on additional conditions or requirements regarding technical and operational capability.	Euroclear should adapt the related Article in its contractual framework so as to avoid discretionary powers that are not based on risk considerations.	By the end of 2015