ECSDA
European Central Securities Depositories Association

29 January 2016

ECSDA response to the Call for evidence on the EU regulatory framework for financial services

Central securities depositories (CSDs) are financial market infrastructures which act as the first point of entry for newly issued securities and subsequently ensure the settlement and safekeeping of these securities. This paper constitutes ECSDA's response to the Call for evidence issued by the European Commission on 30 September 2015. It focuses on those aspects of the consultation which are most relevant from a CSD's perspective.

Key messages

Looking at existing legislation on post trade and more specifically at those pieces of EU law impacting the provision of CSD services, ECSDA would like to make the following recommendations for targeted actions aimed at supporting the Capital Markets Union:

1. **The European Commission should reconsider its approach on impact assessments to add a stronger focus on the impact of legislative proposals on economic growth and job creation.** Some of the requirements imposed by recent EU legislation on post trade generate considerable cost and complexity without any evidence that they will solve existing malfunctions or significantly enhance market safety. The impact of new legislation on the real economy and on the competitiveness of the EU should be systematically included in impact assessments – and should be considered as a key criterion for determining the preferable options. This could include a "global competitiveness test" to ensure that new EU legislation does not put European firms unnecessarily at a competitive disadvantage compared to their non-EU peers. Whenever this test reveals the risk of a significant disadvantage for EU players, law-makers should seek to support global initiatives ahead of taking unilateral action at EU level.

2. **The “Level 1” and “Level 2” processes should be reviewed to avoid unnecessary technical details in binding legislation and to support more consistency between both levels**. In theory, the adoption of Level 2 legislation should make the law-making process more efficient and should provide for more flexibility when technical rules have to be adapted to reflect market reality. In practice, however, the interaction between Level 1 and Level 2 is far from optimal. It is a weakness in the EU legislative process that changes to substantive provisions of a Directive or a Regulation occur via Q&As and Recitals, as has happened with some provisions of the AIFMD and UCITS V where legislators appear to have vacillated over whether or not they wish CSDs to be excluded from the sub deposit obligations. “Early legal reviews” aimed at ensuring that Level 2 measures are consistent with the Level 1 mandates are not transparent and seem to focus exclusively on the letter rather than on the spirit of the Level 1 texts. Moreover, EU legislation on financial services has become excessively prescriptive, with hundreds of pages of binding technical details applying to market processes which are constantly evolving, and at an ever faster pace. In some instances, the Level 1 text itself includes excessive details. As a consequence, legislative reviews often require both Level 1 and Level 2 rules to be amended, rather than the Level 2 alone. This lack of flexibility has the potential to cause major implementation problems, as well as unnecessary costs and complexity for EU market players.

   The CSD Regulation settlement discipline regulatory technical standards are a good illustration of these problems. Looking into the future, the EU Commission should focus more on the quality of the rules adopted, and should seek to reduce the quantity of details in binding legislation. Highly technical aspects are often best addressed at supervisory (rather than regulatory) level.

3. **Law-makers should focus on avoiding overlapping requirements and the inconsistent use of terminology across sectorial pieces of EU law.** In the post trade space, a largely institutional approach has been followed by the legislator whereby each type of financial institution is subject to own regulatory requirements: CSDs are regulated by the CSDR, CCPs by EMIR, trading venues and investment firms by MiFID and MiFIR, banks by the CRD and the CRR, fund managers and fund depositaries by the UCITS and AIFM directives[1]. This approach has several advantages and often helps avoid unnecessary overlaps. However, in some instances, the lack of cross-references and the use of inconsistent terminology creates legal uncertainty and implementation problems. The notions of “custody” and “safekeeping”, for example, appear in several pieces of EU law without always being clearly and explicitly defined. This ambiguity is especially problematic when seeking to determine the applicability of AIFMD requirements to CSDs. In addition, the inconsistency between banking legislation and the CSD Regulation (CSDR) is complex for those CSDs which also hold (or intend to hold) a banking licence.

[1] Although the UCITS and AIFM Directives are primarily pieces of legislations directed at products, rather than at institutions, they contain specific rules for fund managers and fund depositaries.

4. **The EU legislator should avoid imposing requirements indirectly via regulated entities, especially when the regulated entities do not have the means to force third parties to comply with the applicable EU rules.** The CSD Regulation for instance (both in Level 1 and Level 2) has introduced obligations on CSD clients, issuers of securities and transfer agents, although the supervisory framework in the CSDR is solely concerned with CSDs. The use of LEIs for identifying issuers in CSD records is just one example. The consequence is that CSDs may not be able to comply with the CSDR requirements because full compliance would require third parties (such as issuers) to comply with CSDR rules. This is all the more problematic since these third parties will often not be subject to CSDR requirements and may not even have a contractual relationship with a CSD. Such implementation problems can be avoided by ensuring that requirements apply to all relevant entities, even if this requires amending more than one regulation, in line with the principle of Better Regulation.

5. **Finally, EU law should allow for more calibration of the requirements as regards smaller and less systemically important infrastructures**. The focus of the Capital Markets Union (CMU) action plan on SMEs is very welcome, but the same objective of proportionality should extend to requirements on financial institutions. In the EU, many CSDs are small and medium size enterprises, and the requirements imposed on them by the CSD Regulation of September 2014 are sometimes excessively burdensome given their low risk profile compared with larger, more complex and more interconnected infrastructures. This is the case of CSD capital requirements and governance requirements, for example. The EU Commission should seek to ensure that Level 2 standards in particular allow for a proportionate implementation of the Level 1.

A. Rules affecting the ability of the economy to finance itself and grow

Issue #1: Unnecessary regulatory constraints on financing
The Commission launched a consultation in July on the impact of the Capital Requirements Regulation on bank financing of the economy. In addition to the feedback provided to that consultation, please identify undue obstacles to the ability of the wider financial sector to finance the economy, with a particular focus on SME financing, long-term innovation and infrastructure projects and climate finance. Where possible, please provide quantitative estimates to support your assessment.

No comments.

Issue #2: Market liquidity
Please specify whether, and to what extent, the regulatory framework has had any major positive or negative impacts on market liquidity. Please elaborate on the relative significance of such impact in comparison with the impact caused by macroeconomic or other underlying factors.

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- Article 7 of the CSDR (EU Regulation 909/2014)
- ESMA Consultation paper on Technical Standards under the CSD Regulation, 18 December 2014

(b) Please provide us with an executive/succinct summary of your example:

The effect of the settlement discipline regime described in article 7 of the CSDR on market liquidity is likely to be substantial, and yet it is not addressed in the CSDR impact assessment. Despite largely unanimous feedback by industry players on the potential risks of the proposed measures for the liquidity of certain market segments, EU regulators have so far refused to consider a phased-in approach allowing for a gradual implementation of the requirements and for an assessment of the consequences on the liquidity of various financial instruments.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

The ICMA Impact Study for CSDR Mandatory Buy-ins published in February 2015 provides empirical evidence on the likely impact of CSDR settlement discipline rules on market liquidity and efficiency. The report states, for instance, that the *"EUR 5.5 trillion European repo market will (..) be radically re-shaped, driving more reliance on very short-dated repo funding ('exempt' repo), while the more stable, fixed-term repo markets will see dramatic widening of spreads for more liquid securities, and a total withdrawal of liquidity for less liquid securities, including some sovereign and public bonds, and most corporate bonds".*

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

To avoid a detrimental impact of CSDR settlement discipline rules on market liquidity, the EU legislator should consider the possibility of first modelling the impact of the new EU rules in a test environment before enforcing the new requirements on the EU market as a whole. A consideration of the impact on global markets should also be included given the potential extra-territorial nature of some of the rules.

Phased-in requirements would be another possible option, such as that those provisions applied to the net stable funding ratio (NSFR) and the liquidity coverage ratio (LCR) under CRD IV[2].

Issue #3: Investor and consumer protection
Please specify whether, and to what extent, the regulatory framework has had any major positive or negative impacts on investor and consumer protection and confidence.

No comments.

Issue #4: Proportionality / preserving diversity in the EU financial sector
Are EU rules adequately suited to the diversity of financial institutions in the EU? Are these rules adapted to the emergence of new business models and the participation of non-financial actors in the market place? Is further adaptation needed and justified from a risk perspective? If so, which, and how?

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

Example #1: CSDR rules on capital requirements and investment policy

- CSDR (EU Regulation 909/2014): article 46(2) and (4) on investment policy and article 47 on capital requirements
- Draft ESMA regulatory technical standards (RTS) on CSD requirements: article 82 on the "appropriate timeframe for access to assets"
- Draft EBA regulatory technical standards (RTS) on CSD prudential requirements: articles 3 to 7 on capital requirements for non-bank CSDs

Example #2: CSDR governance requirements

- CSDR (EU Regulation 909/2014): article 26 on organisational requirements
- Draft ESMA regulatory technical standards (RTS) on CSD requirements: article 49(9) on "responsibilities of key personnel"

[2] Directive 2013/36/EU

(b) Please provide us with an executive/succinct summary of your example:

Example #1: CSDR rules on capital requirements and investment policy

As far as non-bank CSDs are concerned, the capital requirements imposed by the CSDR are excessively burdensome and will disproportionately impact small and medium sized CSDs, at the detriment of the diversity of financial market players. Excessive complexity stems from the fact that the legal requirements in the CSDR are in large part inspired by the requirements for CCPs and for banks. These requirements, while appropriate for banks and CCPs, do not sufficiently take into account CSDs' specificities and comparatively lower risk profile. In particular:

(1) Ensuring that non-bank CSDs invest their capital in liquid assets whenever possible is a legitimate policy objective, but requiring that they have access to these assets as speedily as in the case of CCPs is disproportionate. Article 82 of the draft ESMA RTS on CSD requirements defines "prompt access" as same-day access, thereby replicating the EMIR requirements for CCPs[3]. This **very restrictive interpretation of the notion of "prompt access"** is excessively burdensome for CSDs because, unlike CCPs and banks, the vast majority of CSDs are not directly exposed to liquidity risk. This is thus not justified from a risk perspective.

(2) The **joint application of article 46(4) and article 47(1) of the CSDR** will also be highly problematic if it means that CSDs can only cover their capital requirements with cash or highly liquid financial instruments. From a prudential perspective, this can be justified for those institutions which face credit and liquidity risks as part of their core activities, given that such institutions may need to replenish any shortfall deriving from those risks with their own financial resources. This is not the case, however, for non-bank CSDs. The main risk CSDs are exposed to is operational risk and today a significant part of a CSD's equity is typically invested in tangible and intangible assets.

Requiring CSDs to deduct assets other than cash and highly liquid financial instruments from the value of assets that can be considered for the purpose of calculating CSD capital requirements is all the more disproportionate since banks cover their regulatory capital with “own funds”, which include investments filtered out by article 46(4) of the CSDR. The exclusion of tangible assets and certain short-term assets in particular should be reconsidered. Taking tangible assets into account in the calculation of risk weighted exposure amounts for credit risk results in the double-counting of CSD investment risks and is thus not justified from a risk perspective. As for short-term assets such as commercial credits and other relevant items which are paid on a regular basis including accounts receivables, prepayments to suppliers or long-term receivables for group companies, they should be treated in the same way as cash and highly liquid financial instruments for the purpose of article 46(4) of the CSDR.

[3] European Market Infrastructure Regulation (EMIR), EU Regulation 648/2012

(3) **The cumulative approach adopted in article 47(1) of the CSDR** is also disproportionate as it will require CSDs to maintain capital well beyond what is expected under the international Principles for financial market infrastructures (PFMI).

The 25% ratio for business risk imposed by article 6(1)(b) of the draft EBA RTS in particular is far too high and is unjustified for several reasons:

- It ignores the fact that CSDs operate on considerably simpler and lower risk business models than banks or CCPs;
- It duplicates with the floor of 6-month operational expenses required for winding-down purposes under article 47 of the CSDR.

Example #2: CSDR governance requirements

The proposed ESMA standards under CSDR article 26 would force CSDs to create three senior positions: Chief Risk Officer (CRO), Chief Compliance Officer (CCO), and Chief Technology Officer (CTO), while requiring that these three roles are exercised by a different individual. While not necessary under the Level 1 mandate, this requirement would impose disproportionate cost and complexity on many small and medium-sized CSDs in the EU for the following reasons:

(1) The risk management function in a CSD is of a different nature than in a CCP. The only reason given by ESMA for imposing a separation of functions is that the CRO should have *"a strong analytical/mathematical/statistical background"*[4], whereas the CCO tends to have a legal background. This point of view assumes that the risks of a CSD can be quantified in the same way as the risks of a CCP, i.e. mathematically. For CSDs which do not perform banking type ancillary services, this view is simply not accurate: CSD risks do not have to do with mathematics or statistics but have to do with legal risks and operational issues.

(2) Compliance should be an integral part of risk management. Although several CSDs may choose to appoint separate individuals as CCO and CRO, there are compelling reasons why some have chosen to entrust both functions to the same individual. Indeed, there are important synergies between the risk management function and the compliance function.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

Example #1: CSDR rules on capital requirements and investment policy

[4] See page 21, paragraph 89 of the ESMA Final Report on Draft technical standards on CSDR requirements, 28 September 2015.

26 out of the 31 CSDs established in the European Union (i.e. 83% of CSDs) do not provide cash credit and are thus not exposed to counterparty credit risk in relation to their participants[5]. This is an important difference with banks and CCPs.
Moreover, unlike CCPs, non-bank CSDs are not directly exposed to liquidity risk: they neither guarantee the performance of settlement with their own assets nor are directly exposed to the default of their participants.

Example #2: CSDR governance requirements

In recent years, several companies opted to merge both the compliance and risk functions in order to make compliance an integral part of risk management. This approach is supported by several academic and regulatory experts[6]. In fact, Recital 15 of Directive 2006/73/EC (MiFID Implementing Directive), which regulates the compliance function in investment firms, states: *"The fact that risk management and compliance functions are performed by the same person does not necessarily jeopardise the independent functioning of each function."* Similarly, the 2005 report of the Basel Committee on Banking Supervision on Compliance and the compliance function in banks states that *"some banks may wish to organise their compliance function within their operational risk function, as there is a close relationship between compliance risk and certain aspects of operational risk."*

Given that the CRD IV recognises that governance requirements can be applied taking into account the size, business activity and complexity of an institution, for example in articles 76(5) and 88(2), ECSDA does not understand why this principle is not reflected in the CSDR, knowing that the majority of CSDs are small institutions with a low level of complexity.

Moreover, in small and medium-sized CSDs which do not perform banking type services, the positions of Chief Compliance Officer and Chief Risk Officer do not correspond to two full time jobs. Finding suitable candidates may thus prove a challenge. Combining both functions would not only make sense from a business perspective, it would also make it easier for smaller CSDs to recruit a highly qualified individual for the job.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

Example #1: CSDR rules on capital requirements and investment policy

More proportionate capital requirements for non-banks CSDs would require a more flexible interpretation of article 47 of the CSDR, allowing the same capital to be held for "going concern" and

[5] This number excludes CSDs operated by central banks, which are not subject to art.46 and 47 of the CSDR.
[6] See for instance:
http://blogs.reuters.com/financial-regulatory-forum/2012/04/05/time-to-merge-risk-management-and-compliance/, http://download.pwc.com/ie/pubs/2014-pwc-ireland-compliance-operational-risk-management.pdf, http://iia.nl/SiteFiles/IIA%20NL%20Combining%20functions%202014.pdf and http://www.post-tradeviews.com/integrating-compliance-risk-management-functions-way-forward/

"winding down" purposes whenever this is justifiable. In other words, points (a) and (b) of article 47(1) should be understood as complementary rather than as strictly cumulative.

Moreover, article 46(4) of the CSDR should be deleted or amended to allow non-financial assets to be taken into consideration for the calculation of CSDs' capital requirements. CSDs should be allowed to apply article 113(1) of the CRR[7] by excluding exposures, which shall not be taken into account for the purposes of article 47(1) of the CSDR, from the calculation of risk weighted exposure amounts for credit risk. This would support the principle of proportionality by acknowledging that non-bank CSDs are not exposed to credit and liquidity risks in the same way as banks and CCPs.

Finally, article 82 of the draft RTS on CSD requirements should be amended as follows:

Article 82 - Appropriate timeframe for access to assets *"1. A CSD that holds cash assets shall have* ***swift*** ***~~immediate~~*** *and unconditional access to such assets. The CSD shall have procedures that prove to the competent authority that it can have immediate and unconditional access to such assets.* *2. A CSD that holds financial instruments shall be capable of* ***liquidating*** *~~accessing~~* ***them within three business days from the moment*** *~~on the same business day~~* ***when a decision to liquidate such financial instruments is taken****. The CSD shall have procedures that prove to the competent authority that it is capable of* ***liquidating*** *~~accessing~~* *the financial instruments* ***~~on the same~~ within three*** *business day****s from the moment*** *when a decision to liquidate such financial instruments is taken."*

There is no reason to require CSDs to have immediate access to the assets invested and to liquidate them on the next business day. A 3-day liquidation period would be more appropriate. CSDs typically plan their liquidity needs taking into account current and projected liabilities and should be able to manage them using this 3-day period. Even in extreme situations, such as the liquidation of the CSD's activities, there is no need to have access to all the assets within a day.

Example #2: CSDR governance requirements

Paragraph 9 of article 49 of the draft ESMA RTS on CSD requirements should be deleted so that CSDs are allowed to appoint the same individual as CCO and CRO.

B. Unnecessary regulatory burdens

Issue #5: Excessive compliance costs and complexity
In response to some of the practices seen in the run-up to the crisis, EU rules have necessarily become more prescriptive. This will help to ensure that firms are held to account, but it can also increase costs and complexity, and weaken a sense of individual responsibility. Please identify and justify such burdens that, in your view, do not meet the objectives set out above efficiently and effectively. Please provide quantitative estimates to support your assessment and distinguish between direct and indirect impacts,

[7] Capital Requirements Regulation (CRR), EU Regulation 575/2013

and between one-off and recurring costs. Please identify areas where they could be simplified, to achieve more efficiently the intended regulatory objective.

The problems described under issue #4 (proportionality) and issue #13 (gaps) will result in excessive compliance costs and complexity for EU CSDs, especially small and medium sized CSDs. Please refer to the answers provided under these two issues for further details.

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- CSDR (EU Regulation 909/2014): article 45(3) on operational risks
- Draft ESMA regulatory technical standards (RTS) on CSD requirements: article 78 on disaster recovery

(b) Please provide us with an executive/succinct summary of your example:

Article 78(2) of the draft ESMA RTS on CSD requirements imposes a two-hour disaster recovery objective. In other words, a CSD is expected to be *"capable of resuming its critical functions"* within two hours from a disruption. Moreover, article 78(3) states that *"a CSD shall maintain at least a secondary processing site with sufficient resources"* and lists several requirements for this processing site.

While these disaster recovery objectives will be appropriate for the largest and most systematically important CSDs, they will not always be justified in the case of smaller and less systematically important infrastructures. Meeting the requirements under article 78 of the draft ESMA RTS will impose considerable costs on small and medium-sized CSDs, both in terms of fixed and recurring costs.

In addition, local market requirements should be taken into account when setting a time limit for disaster recovery. In fact, a 15-minute outage in a highly complex and liquid market could result in higher systemic risk than a 4-hour outage in a small and less liquid market. Having precise limits specified in a legal instrument may actually defeat the purpose of the requirements by adding legal risk in crisis situations without taking into account the fact that market conditions vary considerably across Member States.

The fact that the 2-hour recovery time only applies to critical functions does not necessarily make things easier for smaller CSDs since they tend to operate both critical and non-critical services on a single IT architecture (whether in terms of hardware, software or network).

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

It is difficult to provide cost estimates given the variety of CSDs' business models and given the unique cost structure of each CSD. However, ECSDA would like to point out that several EU CSDs qualify as small or medium-sized companies under EU law and that not all CSDs are equally systemically important. For example, if the two ICSDs are excluded, the average CSD in Europe has slightly more than 100 employees. In the EEA, 15 CSDs had less than 50 employees as at 31 December 2014.

In terms of the value of securities transactions processed by CSDs, it is worth noting that 3 CSDs account for 69% of the total value of instructions collectively processed by the 41 ECSDA members. Whereas 7 CSDs processed more than EUR 50 trillion worth of deliveries in 2014, the 10 smallest CSDs processed instructions worth less than EUR 5 billion. More details on the size and business models of individual CSDs can be found in the 2014 CSD Factbook issued by ECSDA in September 2015.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

Article 78 of the draft ESMA RTS on CSD requirements should be amended as follows to allow for a more proportionate implementation of CSDR article 45, thereby reducing compliance costs and complexity for low risk small and medium-sized CSDs:

Article 78 - Disaster recovery
(…) *"2. The CSD's disaster recovery plan shall identify and include the recovery time objective for critical functions and determine for each critical function the most suitable recovery strategies. The recovery time objective for each critical function* ***shall be set based on a risk analysis and, whenever possible, shall not exceed*** ***~~can in no case be longer than~~*** *two hours. Backup systems should, however, commence processing without undue delay unless this would jeopardise the integrity of the securities issues or the confidentiality of the data maintained by the CSD.* ***~~A CSD shall ensure that two hours from a disruption, it shall be capable of resuming its critical functions.~~*** *In determining the recovery times for each function, the CSD shall take into account the potential overall impact on the market efficiency. Such arrangements shall at least ensure that, in extreme scenarios, agreed service levels are met.*
3. A CSD shall maintain ***~~at least~~*** *a secondary processing site with sufficient resources, capabilities, functionalities and staffing arrangements, which are adequate to the CSD's operational needs and risks that the CSD faces in order to ensure continuity of critical operations, at least in case the main location of business is not available."*

This would allow smaller CSDs to adjust the 2-hour time limit to local market conditions, based on a thorough risk analysis, and in agreement with the local regulator(s).

Issue #6: Reporting and disclosure obligations
The EU has put in place a range of rules designed to increase transparency and provide more information to regulators, investors and the public in general. The information contained in these requirements is necessary to improve oversight and confidence and will ultimately improve the functioning of markets. In some areas, however, the same or similar information may be required to be reported more than once, or requirements may result in information reported in a way which is not useful to provide effective oversight or added value for investors.

Please identify the reporting provisions, either publicly or to supervisory authorities, which in your view either do not meet sufficiently the objectives above or where streamlining/clarifying the obligations would improve quality, effectiveness and coherence. If applicable, please provide specific proposals.
Specifically for investors and competent authorities, please provide an assessment whether the current reporting and disclosure obligations are fit for the purpose of public oversight and ensuring transparency. If applicable, please provide specific examples of missing reporting or disclosure obligations or existing obligations without clear added value.

No comments.

Issue #7: Contractual documentation
Standardised documentation is often necessary to ensure that market participants are subject to the same set of rules throughout the EU in order to facilitate the cross-border provision of services and ensure free movement of capital. When rules change, clients and counterparties are often faced with new contractual documentation. This may add costs and might not always provide greater customer/ investor protection. Please identify specific situations where contractual or regulatory documents need to be updated with unnecessary frequency or are required to contain information that does not adequately meet the objectives above. Please indicate where digitalisation and digital standards could help to simplify and make contractual documentation less costly, and, if applicable, identify any obstacles to this happening.

No comments.

Issue #8: Rules outdated due to technological change
Please specify where the effectiveness of rules could be enhanced to respond to increasingly online-based services and the development of financial technology solutions for the financial services sector.

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- CSDR (EU Regulation 909/2014)

(b) Please provide us with an executive/succinct summary of your example:

Innovation in financial technologies (FinTech) is likely to require a more functional approach in the regulation of securities settlement, in order to avoid creating regulatory gaps and competitive distortions between regulated securities infrastructures (subject to EMIR and the CSDR) and new, unregulated FinTech players offering decentralised post trade services e.g. on the basis of distributed ledger technology (DLT).

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

The technology used to process securities transactions via distributed ledgers is still in early development phase. New protocols are being tested to enhance the reliability of the process, for example by adding a permission system to the distributed ledgers, thereby ensuring that only authorised entities can access the network and discover asset ownership.

In Europe and globally, several securities infrastructures and intermediaries are currently assessing the potential of distributed ledger technologies to enhance their business model for securities transactions. According to some studies, the role of CCPs and CSDs could be diminished or even become redundant as a result of DLTs. Examples of press articles on recent initiatives include:

- 11 May 2015: Nasdaq press release: "Nasdaq Launches Enterprise-Wide Blockchain Technology Initiative"
- 31 July 2015: Forbes article "SETL Industrializes Blockchain For Enterprise-Level Financial Services Settlement" by Tom Groenfeldt
- 18 November 2015: Bravenewcoin article: "Leading clearing houses join London Stock Exchange in exploring the Blockchain" by Luke Parker
- 2 December 2015: Finextra article "Goldman files cryptocurrency-based settlement system patent", including a link to the application file for the patent in the US
- 17 December 2015: Linux Foundation press release "Linux Foundation Unites Industry Leaders to Advance Blockchain Technology"
- 21 January 2016: Digital Asset Holdings press release "Digital Asset closes funding round exceeding USD 50 million from thirteen global financial leaders"
- 25 January 2016: DTCC White Paper "Embracing Disruption – Tapping the Potential of Distributed Ledgers to Improve the Post-Trade Landscape".

A more general study commissioned by the UK government, entitled "Fintech futures," was published in March 2015 and provides an in-depth analysis of the issue.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

FinTech innovations will require monitoring from regulators to avoid regulatory gaps and ensure that EU legislation remains relevant. Before considering legislation on platforms and activities resulting from FinTech innovations, a good starting point could be to create transparency in order to shed more light on activities occurring outside of regulated infrastructures like MiFID trading venues, CCPs and CSDs. Regulators will need to assess the systemic importance of such activities and the related challenges for investor protection before they consider potential adaptations of the regulatory framework to take into account new roles and players.

Issue #9: Barriers to entry

Please document barriers to market entry arising from regulation that the EU should help address. Have the new rules given rise to any new barriers to entry for new market players to challenge incumbents or address hitherto unmet customer needs?

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- CSDR (EU Regulation 909/2014): article 54(5)

(b) Please provide us with an executive/succinct summary of your example:

Article 54(5) of the CSDR only allows CSDs to designate full commercial banks as settlement agents for the purpose of offering settlement in commercial bank money if the value of delivery-versus-payment (DvP) instructions in commercial bank money does not exceed 1% of the total annual value of DvP instructions and EUR 2.5 billion. Such an absolute threshold in Level 1 legislation does not take into account the fact that cross-border (and therefore cross-currency) settlement is increasingly common and that some CSDs may be prevented from offering DvP services for securities denominated in non-domestic currencies as a result of this requirement.

Indeed, to date, no credit institution has signalled its intention to apply for the status of designated credit institution (DCI) under article 54 of the CSDR and ECSDA fears that there is no business case for commercial banks to apply for DCI status unless they fall below the 1% or EUR 2.5 billion threshold. The strict requirements imposed on DCIs by the CSDR are a particular source of concern for those CSDs which currently settle transactions in foreign currencies for amounts above the 1% threshold. Where these CSDs do not have a banking licence, they may be forced to stop offering DvP services for certain securities due to the impossibility to appoint a DCI. This would constitute a step backwards if it results in the settlement of these transactions outside of the CSD infrastructure, undermining the CSDR objective of encouraging DvP settlement whenever possible.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

At least 4 EU CSDs which are not authorised as a banks currently expect their settlement activity in commercial bank money to exceed the article 54(5) threshold. These CSDs would like to designate a credit institution under the CSDR framework for DCIs (a commercial bank or a CSD with a banking licence) but fear that this will not be possible if no EU bank applies for DCI status under the CSDR and if no CSD with a banking licence is able offer the service because of article 54(4)(c).

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

To avoid unnecessarily rigid thresholds in the Level 1 regulation and to support the gradual increase in cross-border transactions at European CSDs, article 54(5) should be amended and replaced by a higher

and more flexible threshold, to be adapted on a regular basis by ESMA based on changing market circumstances and after consulting with national supervisors. CSDs whose settlement volumes in commercial bank money fall below the threshold should be allowed to use either a commercial bank or a CSD authorised to provide banking services as cash settlement agent.

C. Interactions of individual rules, inconsistencies and gaps

Issue #10: Links between individual rules and overall cumulative impact
Given the interconnections within the financial sector, it is important to understand whether the rules on banking, insurance, asset management and other areas are interacting as intended. Please identify and explain why interactions may give rise to unintended consequences that should be taken into account in the review process. Please provide an assessment of their cumulative impact. Please consider whether changes in the sectoral rules have affected the relevancy or effectiveness of the cross-sectoral rules (for example with regard to financial conglomerates). Please explain in what way and provide concrete examples.

No comments.

Issue #11: Definitions
Different pieces of financial services legislation contain similar definitions, but the definitions sometimes vary (for example, the definition of SMEs). Please indicate specific areas of financial services legislation where further clarification and/or consistency of definitions would be beneficial.

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

Example #1: Definitions of "custody" and "safekeeping"

References to safekeeping and custody services of CSDs and/or intermediaries can be found in the following pieces of EU law:

- CSDR (EU Regulation 909/2014): There is no definition of custody or safekeeping in article 2, but the Annex contains a list of CSD services, some of which are generally considered to fall under custody or safekeeping activities;
- MiFID II (Directive 2014/65/EU): Point 1 under Section B of Annex I *("safekeeping and administration of financial instruments for the account of clients")*;
- UCITS (Directive 2009/65/EU as amended by UCITS V): The terms "custody" and "safekeeping" are not included in the definitions under article 2, but these activities are covered in Chapter IV: "Obligation regarding the depositary", especially article 22a(4);
- UCITS V (Directive 2014/91/EC): Recital 21 on *"entrusting the custody of securities of the UCITS"* to a CSD;
- AIFMD (Directive 2011/61/EU): The terms "custody" and "safekeeping" are not included in the definitions under article 4, but they can be derived from article 21(8), which describes the entrusting of assets to fund depositaries for safekeeping and article 22(11) and (12) depositary duties, as well as Recital 41 *on "entrusting the custody of assets to the operator of a securities settlement system"*;
- ESMA Q&A document released on 1 October 2015: Section VI: Depositaries, question and answer 8 (p. 23) on entrusting the custody of an AIF to a CSD.

Example #2: Definitions of "CSD" and "SSS"

"Central securities depository (CSD)" was not defined in EU law before the adoption of the CSDR in 2014. As a result, the term "operator of a securities settlement system (SSS)" is used in several following pieces of EU law adopted prior to 2014 to refer to CSDs:

- SFD (Directive 98/26/EC, last amended in 2014): article 2(a) provides a definition of a "securities settlement system" (entity to be designated by each Member State);
- CSDR (EU Regulation 909/2014): Article 2(1)(1) defines a CSD;
- UCITS V (Directive 2014/91/EC): Recital 21 refers to "CSDs" and "SSS", article 22a(4) to a "SSSs" only;
- AIFMD (Directive 2011/61/EU): "SSSs" and "operators of SSSs" are mentioned in Recital 41 and article 21(11); there is no mention of the term "CSD";
- ESMA Q&A document released on 1 October 2015: Section VI: Depositaries, question and answer 8 (p.23) refers to "CSDs" in relation to article 21(11);
- MiFID II (Directive 2014/65/EU): Recital 41, article 2(1)(o) and article 4(1)(64) all refer to "CSDs";
- EMIR (EU Regulation 648/2012): Recital 51 refers to the SFD definition of an SSS and article 47(3) requires margins[8] and default fund contributions to be deposited with "operators of securities settlement systems".

(b) Please provide us with an executive/succinct summary of your example:

Example #1: Definitions of "custody" and "safekeeping"

A simple way to define the notions of "safekeeping" and "custody" is to describe them as an activity involving the recording of (usually third party) securities on an account and the subsequent maintenance of this account on behalf of the account holder. This activity is *de facto* performed by several market actors, including banks, investment firms and financial market infrastructures like CSDs, although the modalities and the scope of the services provided vary from one actor to the other.

Difficulties arise when we consider the available legal definitions of services which pertain to the performance of a safekeeping or custody activity. Different pieces of EU law use different terminology for describing services involving such activities. The UCITS and AIFM directives use the terms *"safekeeping"* and *"custody"* without providing a clear legal definition. They however refer to the recording of securities on an account as a key part of the safekeeping of financial instruments. MiFID refers to *"safekeeping and administration of financial instruments"*, while the CSDR splits safekeeping/custody activities into a detailed list of services, each of which is included in the Annex, such as:

- the *"notary service"*, defined as the initial recording of securities in a book-entry system;
- the *"central maintenance service"*, defined as providing and maintaining securities accounts at the top tier level;

[8] including margins among interoperable CCPs, as per article 53(3).

- *"supporting the processing of corporate actions";*
- *"new issue services";*
- *"establishing CSD links, providing, maintaining or operating securities accounts in relation to settlement service, collateral management, other ancillary services".*

Dissociating the provision of these safekeeping/custody servvices from core CSD services, including the settlement service, is not realistic in practice. When CSDs accept securities for settlement, they allow their participants to hold these securities in their accounts at the CSD and, whenever an event occurs on the securities, such as the payment of a dividend or an interest payment, the CSD ensures that the corporate actions initiated by the issuer of the securities are duly processed on the accounts. This service is commonly understood as being part of custody or safekeeping performed by a CSD.

Legal uncertainty currently arises in some cases where different regulated entities provide services entailing custody activities to one other.

In the case of MiFID II and the CSDR, certainty has been achieved thanks to consistent cross-references between both texts. Article 73 of the CSDR and article 2(1)(o) of MiFID II provide clarity on cases when the MiFID rules apply to CSDs. The ESMA technical advice on MiFID II of 19 December 2014 further clarifies in paragraph 56 (page 73) that segregation requirements under MiFID apply to assets held by clients at third parties whereas separate segregation requirements apply to assets held at CSDs (cf. article 38 of the CSDR).

Such clarity is unfortunately missing when CSDs perform custody activities for custodian banks acting as fund depositories. The ESMA Q&A published on 1 October 2015 is particularly misleading as it seems to imply that, when CSDs provide core and ancillary services already regulated under the CSDR, they should be subject to AIFMD requirements on the delegation of custody function as soon as their participants act as AIF depositories (see Section VI, question and answer 8). Given that all CSDs perform "custody" activities for their participants and given that it is very common for CSD participants to act as fund depositaries (for alternative investment funds and/or UCITS funds), this interpretation is highly problematic. It could subject EU CSDs to AIFMD requirements "on top of" CSDR requirements for services which are provided as part of CSDs' standard service offering and which are already strictly regulated under the CSDR.

ECSDA finds the ESMA Q&A very difficult to interpret, and we doubt that the EU legislator's intention is to subject all EU CSDs to AIFM requirements whenever CSD participants happen to act as AIF depositaries. In the absence of clear definitions, the current drafting of question and answer 8, Section VI of the ESMA Q&A creates overlaps and legal uncertainty rather than supporting supervisory convergence.

Furthermore, this interpretation contradicts the Level 1 text of the AIFMD. Article 21(11) sets the conditions for the delegation of the custody function and states that: *"the provision of services as*

specified by Directive 98/26/EC by [SSSs] or the provision of similar services by third-country securities settlement systems shall not be considered a delegation of its custody functions." The same logic applies to article 22a(4) of UCITS. It should be noted here that the SFD (Directive 98/26/EC) was drafted with all components of a "system" in mind and hence it should not lead to differentiation of services, unless this is explicitly specified in the legislation.

One example of the inconsistencies in the ESMA Q&A is that it could result in the replication of AIF (and later UCITS V) segregation requirements up to the level of CSDs, in contradiction with CSDR article 38.

Our comments under issue #12 provide more details on the consequences of inconsistent and overlapping account segregation rules.

Example #2: Definitions of "CSD" and "SSS"

As stated under example #1, references to CSDs in MIFID II are consistent, and there is clarity on when the MiFID rules apply to CSDs thanks to the cross-reference between article 73 of the CSDR and article 2(1)(o) of MIFID II.

Definitional problems arise with references to "CSDs" and "SSSs" in UCITS V, the AIFMD and the ESMA Q&A. This can be partly explained by the fact that the CSDR had not been adopted at the time of AIFMD publication, and so references to "SSSs" and the SFD were the only way to address CSD activities. Since the entry into force of the CSDR in September 2014, there is a legal definition of a "CSD" which has the advantage of being more precise than that of "SSS" in the SFD.

As stated in article 18(2) of the CSDR, *"securities settlement systems may be operated only by authorised CSDs"* and, as per the definition under article 2(1)(1), it is impossible for a CSD not to operate a securities settlement system (an entity which does not operate an SSS is not eligible to become a CSD). In other words, the operator of a SSS is by definition a CSD and the reverse is also true. UCITS V, the AIFMD and the ESMA Q&As should be amended to reflect this equivalence of definitions. This would promote consistent outcomes while avoiding an artificial distinction between identical notions (operator of an SSS and CSD).

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

For both examples, the "evidence" on the lack of consistent definitions is provided under point (a), i.e. it is contained in the legal texts themselves.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

For both examples, ECSDA recommends performing a “clean-up” exercise and introducing clear references to CSDs by using the CSDR terminology in other pieces of EU legislation, and in particular asset management legislation and the related guidance.

Example #1: Definitions of "custody" and “safekeeping”

ECSDA assumes that the EU legislator has deliberately avoided the use of the term “custody” in the list of services contained in the CSDR Annex to reflect the fact that the framework for the services provided by CSDs is typically distinct from those provided by entities to which fund depositary banks delegate custody, both from a regulatory and from an operational point of view. Unlike intermediaries qualifying as “depositaries” under UCITS V and AIFMD, CSDs are subject to specific rules in terms of bookkeeping, maintenance of accounts, reconciliation, asset protection, and settlement finality. Securities held via CSD links enjoy the same level of protection.

A consistent approach would thus require redrafting UCITS V, the AIFMD and the ESMA Q&As in such a way that CSDs’ services are described with CSDR terminology. This would remove the current legal uncertainty around the notion of “custody” in a CSD context.

Example #2: Definitions of "CSD" and "SSS"

To avoid creating an artificial distinction between the notions of “operator of an SSS” and “CSD” and the resulting confusion and uncertainty, AIFMD, UCITS V, the ESMA Q&A and possibly other pieces of EU law should be drafted in such a way that CSDs and CSD services are described using CSDR terminology.

Issue #12: Overlaps, duplications and inconsistencies
Please indicate specific areas of financial services legislation where there are overlapping, duplicative or inconsistent requirements.

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- CSDR (EU Regulation 909/2014): article 38 on account segregation;
- AIFMD (Directive 2011/61/EU): article 21, especially paragraphs 8 and 11, on segregation requirements for fund assets held in custody;
- ESMA Q&A document released on 1 October 2015: question 8 (p. 23) on entrusting the custody of an AIF to a CSD.

(b) Please provide us with an executive/succinct summary of your example:

Article 38 of the CSDR establishes the principle of “investor choice” on the level of segregation to be used by participants in their accounts at a CSD. It also states that Member States are not allowed to impose end investor segregation by law unless such legislation is already in place, and only as long as it is not amended. At the same time, CSDs and their participants are subject to new disclosure requirements aimed at providing their clients with full transparency on the costs and level of protection of the different segregation options. Furthermore, the CSDR does not require segregation across CSD links.

The AIFMD (and in the future, UCITS) imposes other segregation rules for the assets of investment funds. In principle, these directives are sectoral and do not include CSDs in their scope. Indeed, article 22a(4) of UCITS V and article 21(11) of the AIMFD state that the delegation of the custody function does not apply to assets deposited with securities settlement systems operated by CSDs. Nonetheless, an inconsistency has emerged with the publication by ESMA of a new question and answer (Q8) in the AIFMD Q&A document of 1 October 2015. The ESMA guidance contradicts the text of the Level 1 legislation by suggesting that AIF depositaries and their subcustodians may be required to maintain segregated accounts at CSD level in cases where a CSD is deemed to provide "custody" services.

As explained under issue #11, the ESMA Q&A is not helpful because it does not define “custody”, and it could result in serious implementation issues if it forces CSDs to treat certain participants differently from others, i.e. article 38 of the CSDR on “investor choice” would only apply to those CSD participants which do not act as fund depositaries.

Moreover, even if "custody" is interpreted as applying only in those cases where a CSD holds assets on behalf of fund depositaries at other CSDs in the context of CSD links, this could still be problematic for operational and regulatory reasons:

- Operationally, the application of AIFMD segregation requirements would prevent CSDs from operating CSD links through omnibus accounts. This would require a change in the operating model currently in use and the consolidated impact at European level would have to be assessed, including the effects of a major increase in the number of accounts maintained at CSDs on the efficiency of cross-border settlement and the related impact on the Eurosystem TARGET2-Securities platform. There is a risk that requiring the use of segregated accounts by a subcategory of CSD participants could have a detrimental impact on the efficiency of CSD links, potentially hampering cross-border collateral movements, without any obvious benefits in terms of asset safety or investor protection.
- As for the regulatory aspects, maintaining the ESMA Q&A as such could require CSDs to review legal arrangements with participants in a substantial way. Assessing the scale and exact nature of the changes is however impossible at this stage given the remaining level of uncertainty (e.g. on the detailed segregation requirements).

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

In October 2015, ECSDA issued a comprehensive report on account segregation practices of European CSDs, based on data from 41 CSDs across 37 markets. This report provides concrete and verifiable evidence on current account segregation options available at CSDs. Section 4 of the report (p. 27-28) outlines some inconsistencies in the EU regulatory framework.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

See ECSDA's proposed solutions under issue #11.

Issue #13: Gaps
While the recently adopted financial legislation has addressed the most pressing issues identified following the financial crisis, it is also important to consider whether they are any significant regulatory gaps. Please indicate to what extent the existing rules have met their objectives and identify any remaining gaps that should be addressed.

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

Example #1: Use of LEIs for issuers in CSD records

- CSDR (EU Regulation 909/2014): article 29 on CSD record keeping;
- Draft ESMA implementing technical standards (ITS) on CSD requirements: article 11(5)(d) on CSD records;

Example #2: Daily reconciliation between CSDs and transfer agents

- CSDR (EU Regulation 909/2014): article 37 on the integrity of the issue and the reconciliation process;
- Draft ESMA regulatory technical standards (RTS) on CSD requirements: article 62 on daily reconciliation with fund transfer agents.

(b) Please provide us with an executive/succinct summary of your example:

Unlike CSDs, issuers and transfer agents are not subject to the CSD Regulation. In both examples (article 29 on record keeping and article 37 on reconciliation), the CSDR requirements are excessively burdensome and will create practical implementation issues because they do not take into account the

fact that CSDs are not in a position to force third parties (issuers or transfer agents) to comply with the CSDR requirements.

(c) ***Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)***

Example #1: Use of LEIs for issuers in CSD records

As regards CSDR article 29 and article 11(5)(d) of the draft ESMA ITS on record keeping, the requirement for CSDs to maintain legal entity identifiers (LEIs) for issuers as part of their records appears disproportionate and impossible to implement in practice.
Many CSDs do not have a contractual relationship with issuers for whom they provide notary services, and thus they cannot force issuers to obtain an LEI, even more so with third country issuers established outside the European Union. ECSDA does not think that the Level 1 CSDR mandates ESMA to impose obligations on issuers via the draft ITS.

Example #2: Daily reconciliation between CSDs and transfer agents

Article 62 of the draft ESMA RTS under CSDR article 37 imposes daily reconciliation between a CSD and a fund transfer agent for all investment funds which are accepted for settlement in a CSD. This requirement is problematic because:

i. **CSDs cannot force fund transfer agents (TAs) to reconcile daily**. Several investment funds, including Luxembourg and Irish mutual funds (AIFs and UCITS), have a monthly or weekly net asset value (NAV), and daily reconciliation is thus not offered by the transfer agent. TAs are not regulated under AIFMD and UCITS, and CSDs simply do not have the means to force them to comply with the CSDR requirement of daily reconciliation.

ii. **Reconciliation requirements are only meaningful in cases where the CSD is responsible for the integrity of the issue**. Article 37 of the CSDR addresses the “integrity of the issue”, which is directly dependent on the CSD providing the notary and/or central maintenance service for a given security. In many cases and for most cross-border funds, it is the fund transfer agent and not the CSD which is responsible for the integrity of the issue. The spirit of the Level 2 reconciliation requirements should be to ensure that CSDs have solid reconciliation procedures when providing notary and/or central maintenance services, not to address cases where other entities than CSDs are responsible for maintaining the integrity of the issue.

iii. **The draft ESMA RTS would have a highly detrimental impact on the efficiency of the fund market.** CSD services contribute to a greater automation of investment funds processing, especially cross-border, an objective long supported by regulators worldwide. If it remains unchanged, article 62 of the draft RTS could lead to the removal of hundreds of investment funds from CSDs as a result of the non-compliance of some transfer agents. This would have a

detrimental impact on market safety and efficiency, and would represent a step backwards as regards efforts made to support the cross border distribution of investment funds.

iv. **The ESMA proposal contradicts the Level 1 CSDR, which includes an explicit exemption for transfer agents**. Transfer agents are explicitly excluded from the scope of the CSDR by Recital 26 of the Level 1 text. Imposing requirements on transfer agents via CSDs is inconsistent, in addition to being practically impossible to implement.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

Example #1: Use of LEIs for issuers in CSD records

CSDs should not have to maintain LEIs for issuers as long as issuers are not required to have an LEI. If the EU legislator wishes to require all issuers of securities to obtain an LEI, it should include this obligation in a piece of EU law that applies to issuers (rather than to CSDs), such as the Prospectus Directive (which is currently under review).
Point (d) under article 11(5) of the draft ITS on CSD requirements (p. 123) should be deleted. Field 1 in Table 2 of Annex IV of the ITS (p. 165) should be amended as follows:

*"ISO 17442 Legal Entity Identifier (LEI) 20 alphanumerical character code, or Bank Identifier Code (BIC) for legal persons with the obligation to convert to LEI for the purposes of reporting to authorities, or **full legal name**"*

Example #2: Daily reconciliation between CSDs and transfer agents

Article 62 of the draft ESMA RTS should be revised thoroughly. CSDs should not be expected to impose daily reconciliation on third parties, especially when they do not provide notary and/or central maintenance services for the securities. If the EU legislator wishes to improve reconciliation practices of fund transfer agents, this should be included as part of the upcoming analysis of barriers to the efficient cross-border distribution of funds announced for mid-2016 as part of the CMU action plan.

D. Rules giving rise to possible other unintended consequences

Issue #14: Risk
EU rules have been put in place to reduce risk in the financial system and to discourage excessive risk-taking, without unduly dampening sustainable growth. However, this may have led to risk being shifted elsewhere within the financial system to avoid regulation or indeed the rules unintentionally may have led to less resilient financial institutions. Please indicate whether, how and why in your view such unintended consequences have emerged.

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- CSDR (EU Regulation 909/2014): article 7(13) on settlement discipline and article 37 on the integrity of the issue and the reconciliation process;
- Draft ESMA regulatory technical standards (RTS) on CSD requirements: article 62 on daily reconciliation with fund transfer agents.

(b) Please provide us with an executive/succinct summary of your example:

One of the dangers of adopting an institutional (rather than a functional) approach to regulation is that regulators tend to focus solely on the risk profile of the regulated institution and do not sufficiently take into consideration the fact that business may migrate to (1) other market players not covered by the regulation or (2) outside the EU.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

For instance, imposing daily reconciliation requirements between transfer agents and CSDs will not improve investor protection if investment funds end up being held outside of CSD systems, as explained under issue #13. The funds, if held at intermediaries rather than infrastructures, will be covered by reconciliation requirements under MiFID rather than by the much stricter requirements under the CSDR. Regulators may think that such measures enhance the risk profile of CSDs, but the risk profile of investors actually increases as a result of business migrating outside of regulated infrastructures.

Another example is article 7(13) of the CSDR which exempt shares principally traded outside the EU from settlement discipline measures. The fact that the same exemption does not apply to other financial instruments than shares creates a competitive distortion. It means that market players who trade Microsoft shares in the EU are exempt from settlement discipline rules, whereas market players who trade US Treasury bills are not. A likely consequence of this distortion will be to encourage market players to trade US Treasury Bills (for instance) on non-EU trading venues, at the detriment of the European capital market.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

Provisions putting EU infrastructures at a disadvantage to their global counterparts and which are not justified by a legitimate policy concern should be avoided. Article 7(13) of the CSDR, for instance, should be amended so that all financial instruments traded on non-EU venues are treated in a consistent way. Furthermore, an excessive level of detail should be avoided both in Level 1 and Level 2 legislation. Too detailed rules can be counter-productive in terms of risk management as they tend to force financial institutions to focus on compliance and procedures, rather than on the real sources of risk and on how to best address them.

Issue #15: Procyclicality
EU rules have been put in place to make the financial system less procyclical and more stable through the business and credit cycle. Please indicate whether some rules have unintentionally increased the procyclicality of the financial system and how.

No comments.

About ECSDA

The European Central Securities Depositories Association (ECSDA) is a member of the EU Transparency Register under number 92773882668-44. The association represents 41 central securities depositories (CSDs) across 37 European countries. As regulated financial market infrastructures, CSDs play a vital role in supporting safe and efficient securities transactions, whether domestic cross-border. If you have any questions on this paper, please contact Ms Soraya Belghazi, Secretary General, at info@ecsda.eu or +32 2 230 99 01.