ECSDA
European Central Securities Depositories Association

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ECSDA comments on the Capital Markets Union Green Paper

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 contains comments on those aspects of the Commission Green Paper and accompanying Staff Working Document of 18 February 2015 which are most relevant from a CSD's perspective. As a result, it mainly addresses Section 4.3 on *"Improving market effectiveness – intermediaries, infrastructures and the broader legal framework"*.

Key messages

European CSDs believe that the project of a Capital Markets Union can act as a catalyst for various initiatives aimed at promoting sound, efficient and internationally attractive financial markets within the next five years. As regards the post trade segment of financial markets, regulations adopted by the previous EU legislature have created a comprehensive and detailed framework, within which CSDs and other financial market infrastructures must now operate. From a CSD perspective, the following priorities should be taken into consideration by the European Commission when developing its CMU action plan:

1. **The very first priority of the Commission should be to ensure that recently adopted EU laws are consistently implemented**. This includes monitoring, preventing and addressing divergences in the transposition and implementation of EU rules into national law. For example, ensuring that national authorities apply the conditions for the authorisation of a CSD consistently across all EEA markets within the framework of the CSD Regulation will be important to avoid gold-plating and potential competitive distortions during the authorisation process in early 2016.
   Similarly, in the field of insolvency law, the European Commission can play a role in reducing inconsistencies by encouraging a more harmonised interpretation and implementation of existing EU laws in the field of insolvency procedures (Settlement Finality Directive, Financial Collateral Directive, Winding-up Directive). Such convergence in implementation would be beneficial without requiring a substantial harmonisation of insolvency procedures (which is probably unrealistic given that such area of the law remains primarily a national competence).

2. **Second, current and future legislative proposals should be assessed against the CMU objectives prior to being adopted by the EU legislator**. New legislation must be geared towards supporting well-functioning and internationally attractive financial markets. CSDs fear that some recent EU legislative proposals could undermine the success of the CMU project if they are not properly recalibrated. This is for example the case of some technical standards under the CSD Regulation (CSDR) which could create new obstacles for the cross-border issuance and/or trading of securities within the single market.

3. **Third, EU initiatives in the post trade sector should focus on public sector barriers which prevent efficient cross-border securities transactions**. Most private sector barriers have been removed over the past ten years, and progress has often been hampered by remaining legal and fiscal restrictions.

   For example, ECSDA understands that the European Commission is considering the possibility of issuing a legislative proposal on the harmonisation of securities laws, including rules related to securities ownership. ECSDA believes that such legislation should only be proposed if (1) it focuses on the book entry principle instead of attempting to achieve widespread harmonisation of material aspects of securities law, (2) it includes conflicts of law rules based on the PRIMA rule and (3) it follows a horizontal approach, clarifying the role and responsibilities of all account providers in the securities chains and ensuring a consistent approach for account segregation requirements at intermediaries and market infrastructures.

   As regards possible legislation on the recovery and resolution of financial market infrastructures other than CCPs, ECSDA is not convinced that it is required to specify details of CSD recovery plans, especially given that the contents of recovery plans are addressed by international Principles and EU technical standards, and given that recovery anyways requires a certain degree of flexibility and discretion on the part of the CSD to be effective. Nonetheless, if separate EU legislation on the recovery and resolution of CSDs is ever to be considered by the European Commission, ECSDA recommends that it should focus primarily on resolution by public authorities, and in particular on cross-border resolution scenarios, rather than on recovery.

4. **Finally, achieving the objectives of the Capital Markets Union will not always require regulation, as market-driven solutions will sometimes be more effective**, for example in the fields of investor education or cross-border investment funds processing.

Responses to the consultation questions

Q1: Beyond the five priority areas identified for short term action, what other areas should be prioritised?

ECSDA believes that the five priority areas identified by the European Commission for short term action are generally appropriate. As regards the first priority area on lowering barriers to accessing capital markets, ECSDA would like to stress that **the remaining barriers to efficient post trade processes in the context of cross-border securities transactions are public sector barriers, such as tax and legal restrictions.** Since the adoption of the final CESAME report in 2008, the so-called "Giovannini barriers" to efficient clearing and settlement have in great part been dismantled as far as the private sector is concerned, whereas progress has been slower on public sector barriers. Tax barriers are only subject to non-binding recommendations, and legal barriers still persist in the absence of further harmonisation of securities laws across the EU. Any attempt to improve access to post trade financial market infrastructures should thus focus on those public sector barriers.

Given the depth and scope of EU legislation adopted in the previous legislature (2009-2014) to regulate financial market actors, including market infrastructures, ECSDA believes that **the priority of the current Commission should be to ensure that recently adopted EU laws are consistently implemented,** and that ongoing legislative proposals are geared towards supporting well-functioning and internationally attractive financial markets. In this respect, non-legislative initiatives such as projects to enhance investors' understanding of capital markets, should also be considered a priority, as suggested for instance in a recent report on IPOs by FESE, EVCA and EuropeanIssuers[1].

Q17: How can cross-border retail participation in UCITS be increased?

CSDs usually only have wholesale financial institutions as customers and thus do not have a direct role to play in the participation of retail investors in UCITS funds. Nevertheless, **CSDs can indirectly facilitate cross-border transactions in UCITS funds by supporting the harmonisation and automation of investment funds processing**, at least for funds which are sufficiently standardised to be settled in CSDs. Some European CSDs process important volumes of investment funds transactions and several ECSDA members have developed solutions for domestic and/or non-domestic funds, aiming to reduce the costs of investing in investment funds by creating economies of scale and processing efficiencies.

The implementation of TARGET2-Securities (T2S), the Eurosystem's shared IT platform allowing CSDs to commoditise securities settlement, will start in 2017 and could potentially make it easier for market

[1] See http://www.europeanissuers.eu/_mdb/spotlight/44en_Final_report_IPO_Task_Force_20150323.pdf

participants to settle transactions in investment funds in central bank money (rather than in commercial bank money), including for cross-border transactions among T2S-participating CSDs. This could bring benefits in terms of choice and safety for UCITS investors. Such developments do not require any legislative action at EU level, but ECSDA believes that the European Commission should encourage industry initiatives going in the direction of more automation and harmonisation of investment funds processing, as was done with the Fund Processing Passport (FPP) initiative[2]. ECSDA stands ready to participate in such initiatives and to raise awareness on the way CSDs can contribute to make the investment funds market safer and more efficient for the benefit of fund managers and investors.

Q24: In your view, are there areas where the single rulebook remains insufficiently developed?

As regards the recovery and resolution framework for non-bank financial institutions, ECSDA understands that the European Commission is working on a legislative proposal for CCPs and for insurance firms, which are due to be released in the course of 2015.

ECSDA agrees with the statement, in the Staff Working Document (p.15), that recovery and resolution of CCPs should be a priority in light of the systemic risk implications. As regards the possibility of a separate legislative proposal on the recovery and resolution of CSDs, ECSDA believes that such a proposal should only be included in the Commission's Action Plan for a Capital Markets Union if it meets the following conditions:

(1) It should be distinct from the legislative proposal on CCPs and properly reflect CSD specificities, in particular the fact that CSDs are not directly exposed to the failure of their participants, typically do not need to maintain default funds and do not have loss sharing rules similar to these of CCPs.

(2) It should be fully consistent with the international Principles for financial market infrastructures (PFMI) and the FSB Guidance for the resolution systemically important financial institutions.

(3) It should focus on cross-border resolution scenarios and avoid prescriptive rules as regards recovery plans. Indeed, CSDs are already subject to compulsory recovery and resolution plans under the CSD Regulation (CSDR), and recovery plans are currently drafted based on the PFMI, and assessed by CSDs' competent authorities. A recovery plan, to be effective, requires a certain degree of discretion on the part of the CSD, and the "toolbox approach" adopted in the PFMI recognises that different business models will require a different combination of recovery tools. Mandating the use of certain tools in an EU regulation could thus hamper effective recovery by removing the discretion and flexibility necessary to deal with crisis scenarios. Detailed

[2] More details are available on the EFAMA website at:
http://www.efama.org/Lists/Topics/form/DispItem.aspx?ID=15

prescriptions on CSD recovery plans are even less necessary now that the CSDR technical standards are expected to provide a common outline for all CSDs to comply with.

As regards resolution however, having EU legislation superseding any potentially conflicting national rules on the resolution of infrastructures could help overcome practical and legal problems in case a CSD active on a cross-border basis ever needs to be resolved.

In short, ECSDA believes that **legislation is not needed to specify details of CSD recovery plans, given the rules already in place in the CSDR and the PFMI. Instead, any future EU legislative proposal in this area should focus on CSD resolution (rather than recovery)**, and in particular on cross-border resolution scenarios.

Q25: Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a capital markets union?

As regards the supervision of CSDs, ECSDA believes that the current framework is appropriate and sufficient. In line with the subsidiarity principle, we believe that CSDs which are active primarily at the domestic level should continue to be supervised by national competent authorities, and that the involvement of authorities from other Member States in the supervision of a CSD is only warranted in case the CSD activities are of substantial importance to these ("host") Member States. At the present time, ECSDA does not believe that a direct supervision of CSDs by ESMA, for instance, is likely to bring any benefits compared to the recently established supervisory arrangements under the CSDR.

Q26: Taking into account past experience, are there targeted changes to securities ownership rules that could contribute to more integrated capital markets within the EU?

ECSDA supports the adoption of a legislative proposal further harmonising securities laws, including rules related to securities ownership, as part of the Capital Markets Union 2019 Action Plan, provided that the following conditions are met:

(1) The legislative proposal should focus on a few specific aspects of securities law and should not attempt to achieve widespread harmonisation of material aspects of securities law, which is likely to prove to be extremely complex. Embarking on a more ambitious harmonisation effort of current national regimes in order to address the substantial issue of "who owns what" would first require a comprehensive assessment of the benefits and disadvantages of all the current regimes in Europe.

Meaningful harmonisation can be achieved by implementing the book-entry principle across the EU, in order to reduce obstacles and legal uncertainties around cross-border holdings and transfers of securities. This would include making acquisitions and dispositions of securities

effective by the crediting, debiting or earmarking of a securities account and the implementation of a general “no credit without debit” principle (however recognising that there are certain cases where such a principle is impractical).

(2) Moreover, the proposal should introduce **harmonised conflicts-of-law rules** applicable to all aspects of holding, acquisition and disposition of securities following the PRIMA principle, already adopted by the Settlement Finality Directive (SFD) and the Financial Collateral Directive (FCD). Currently, harmonised rules on the ownership of securities are included in the FCD as well as in the SFD, but in both cases they are limited in their scope. While art.8 of the SFD applies to insolvency proceedings only, art.9(2) of the SFD and art.9 of the FCD are restricted to collateral transactions. Extending these rules to cover all proprietary aspects of securities holdings would strengthen legal certainty for cross-border securities transactions. In line with the T2S AG response to this consultation, ECSDA believes that such a rule should follow the PRIMA principle. In other words, the applicable law to securities accounts at the CSD should be the one of the country where the CSD is legally established.

(3) Third, such EU legislation should retain a broadly **functional and horizontal approach.** Its primary objective should be to increase transparency and enhance the legal certainty of collateral holdings throughout the entire securities holding chain. As “horizontal” legislation, it should moreover aim to complement the different pieces of sectorial legislation already adopted (MiFID, EMIR, CSDR etc.) in order to avoid overlaps and inconsistencies.

(4) Fourth, legal certainty could be enhanced by adopting **harmonised rules on the valid acquisition of collateral**, as recommended by the T2S Advisory Group and the COGESI group among others in their responses to the Green Paper consultation. Harmonising the legal aspects of collateral techniques could involve the reduction of national restrictions on pledges and other security interests, while strengthening of title transfer collateral arrangements in insolvency.

(5) **Finally, any upcoming legislative proposal should aim to specify the role and responsibilities of all account providers (including CSDs) and to introduce consistent rules on the segregation of client securities accounts**. The current fragmented approach includes different rules on account segregation spread over many pieces of legislation (EMIR, MiFID, CSDR etc.) and there does not seem to be a clear vision in terms of the right "level" in the chain where segregation should be encouraged to ensure maximum investor protection. A more consistent and truly harmonised approach on this important issue would benefit investor and issuer transparency, while clarifying the rules to which intermediaries and infrastructures are subject to in relation to account and asset segregation.

Q27: What measures could be taken to improve the cross-border flow of collateral? Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?

A further harmonisation of securities law through EU legislation covering the aspects mentioned in our response to question 26 could significantly strengthen legal certainty in relation to cross-border securities holdings and would therefore also improve the cross-border flow of collateral.

As regards close-out netting arrangements in particular, ECSDA supports initiatives enhancing their legal enforceability in cross-border scenarios, in line with the UNIDROIT principles on the operation of close-out netting provisions. Further consistency could be achieved not only in relation to the enforceability of close-out netting arrangements in insolvency proceedings, but also as regards the categories of parties eligible for using close-out netting arrangements.

Q28: What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?

In some cases, **the lack of transparency preventing issuers from obtaining information on the identity of their shareholders can create dis-incentives for the cross-border issuance and trading of financial instruments.** Existing processes for shareholder identification generally work well at domestic level, but are not always efficient when it comes to identifying non-domestic shareholders, primarily because the flow of information is less automated and involves longer chains of intermediaries.

Moreover, **differences in national rules for exercising shareholder rights and executing corporate actions** result in high costs for foreign intermediaries and infrastructures seeking to provide cross-border services while increasing the risk of infringement (since foreign entities are not always fully aware and familiar with local regulations).

Commission proposal COM/2014/213 for a review of the Shareholder Rights Directive (SRD) has the potential to address some of the obstacles to cross-border shareholder identification and the cross-border exercise of shareholder rights. However it is unlikely to solve the problem without a parallel harmonisation of securities law. Once implemented, the impact of the revised SRD will have to be closely monitored in order to assess whether further improvements, through legislation or through industry initiatives, are needed.

Q29: What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

ECSDA agrees with the Commission that substantial divergences among national insolvency laws and procedures may create legal uncertainty and can be a barrier for cross-border securities investments. From a CSD's perspective, significant differences or incompatibilities in formal insolvency proceedings

have negative repercussions on cross-border securities operations. We therefore support the assessment in the Green Paper (p.25) that *"reducing these divergences could contribute to the emergence of pan-European equity and debt markets, by reducing uncertainty for investors needing to assess the risks in several Member States."* An important consideration in this respect is the need to mitigate the retroactive effects of an insolvency declaration and to ensure the irrevocability of settlement executed on the basis of instructions sent to a CSD's settlement system on or before the date of the insolvency declaration, in line with existing settlement finality rules.

A substantial harmonisation of insolvency procedures through EU law is probably unrealistic given that this area of law remains primarily a national competence. Yet ECSDA believes that there is some room for action to gradually reduce divergences. For instance, we welcome the ongoing work in the context of T2S as regards the treatment of pending (cross-border) settlement instructions in the case of insolvency. ECSDA also agrees with the response of the T2S AG to this consultation as regards **the need for the European Commission to address certain existing divergences in the transposition into national law of the relevant EU laws in the field of insolvency procedures (SFD, FCD, and Winding-up Directive).** Indeed, in the context of cross-border insolvency proceedings, it is very important that the enforceability of financial collateral arrangements, close-out netting arrangements, as well as the redelivery of collateral securities, be legally clear and easily understood, so that collateral does not get 'trapped' in insolvency.

Finally, the rules related to the insolvency of intermediaries in collateral chains could be harmonised.

Q30: What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?

ECSDA supports the Commission Recommendation of 19 October 2009 on withholding tax relief procedures[3] and believes that the Commission should pursue its efforts in this area, including by monitoring implementation, reporting regularly on the progress made, and ensuring that the EU is aligned as much as possible with international best practices in relation to withholding tax procedures (cf. OECD initiatives for instance).

Indeed, **simplifying existing procedures for tax relief at source could contribute to make European financial markets more attractive for international investors**. Today, the ability of foreign investors to apply such relief is limited in practice due to the restrictions in local regulations governing the provision of the necessary documentation to prove that investors are entitled to tax relief, in particular because the required deadlines are often impossible to meet. As a result, foreign investors often need to apply for a refund of the overpaid tax, a long-drawn-out procedure that in effect discourages cross-

[3] See http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32009H0784

border investment. The ideal approach would be a considerable simplification and elimination of unnecessary formalities governing the rules for applying for relief at source, ensuring that:

- withholding agents (which can be issuers, account providers, CSDs) are not exposed to the risk of making additional tax payments in the event that the right to relief at source is denied by the relevant tax authorities,
- each jurisdiction has effective means for reclaiming non-fully paid tax throughout the whole EU.

Other aspects worth considering include **differences in the way Member States deduct issuer expenses with respect to share capital increases and rights issues, as well as rules for taxing income from capital investments.** These rules have an effect on the decision of companies to raise capital: SMEs in particular will consider the impact of these rules on financing options and market depth to assess whether raising capital via a securities issue is a realistic choice.

Q32: Are there other issues, not identified in this Green Paper, which in your view require action to achieve a Capital Markets Union? If so, what are they and what form could such action take?

ECSDA strongly supports the overarching goal of the CMU initiative to build a real single market for capital in Europe and to maximise its benefits as a means to boost growth and job creation. We believe all legislative initiatives in the area of financial services that are currently being discussed should be consistent with these objectives and support them as much as possible. ECSDA is concerned that some recent legislative proposals could undermine the success of the CMU project, such as:

- the upcoming CSD Regulation technical standards on settlement discipline, which could render EU securities and in particular EU post trade infrastructures unattractive compared to their international peers[4];

- the upcoming CSD Regulation technical standards on CSD links, in the case that they create unnecessary obstacles to the establishment and maintenance of links between EU and non-EU CSDs[5];

- the upcoming CSD Regulation technical standards on CSD prudential requirements which, if unnecessarily restrictive, could put European CSDs at a disadvantage compared to non-EU infrastructures. In addition to imposing levels of capital that go far beyond international Principles for financial market infrastructures, including for CSDs with the lowest risk profile, the draft EBA standards currently being finalised could undermine the attractiveness of

[4] See http://ecsda.eu/wp-content/uploads/2015_02_19_ECSDA_CSDR_Part1.pdf
[5] See http://ecsda.eu/wp-content/uploads/2014_02_19_ECSDA_CSDR_Part2.pdf

issuance in the EU by requiring that CSDs obtain an irrevocable guarantee from paying agents or issuer agents in case custody payments are advanced by the CSD[6];

- the proposal of European financial transaction tax (FTT) which, depending on its design, could also significantly hamper the attractiveness of European financial markets.

ECSDA does not oppose these ongoing initiatives as such, but believes that the measures they contain should be carefully calibrated with the CMU objectives in mind.

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.

[6] See http://ecsda.eu/wp-content/uploads/2015_04_27_ECSDA_Response_EBA_CSDR.pdf as well as art.27(c) of the draft EBA standards, available at: http://www.eba.europa.eu/documents/10180/995469/EBA-CP-2015-02+%28CP+on+RTS+on+prudential+requirements+for+CSDs%29.pdf