European Economic and Social Committee

OPINION

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Central Securities Depositories review

Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 909/2014 as regards settlement discipline, cross-border provision of services, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories
[COM(2022) 120 final – 2022/0074 (COD)]

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Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Adopted in section	01/07/2022
Adopted at plenary	14/07/2022
Plenary session No	571
Outcome of vote (for/against/abstentions)	185/0/1//

1. Conclusions and recommendations

1.1 The Committee finds the solutions proposed by the Commission to the five main issues identified during the Central Securities Depositories Regulation (CSDR) review process to be, in general, sufficient and effective. With more efficient EU settlement procedures, the capital markets will become more attractive to both issuers and investors, and we will be one step closer to achieving the Capital Markets Union (CMU).

1.2 The EESC welcomes the Commission's proportionate initiatives to replace existing passporting requirements with a notification, as well as a proposal for better supervisory cooperation by establishing appropriate, but not duplicate, supervisory colleges.

1.3 Concerning the provision of banking-type ancillary services, the Committee sees further opportunities in solutions based on settlement in central bank money. To further decrease a range of different risks, greater use should be made of the existing TARGET2-Securities (T2S) multicurrency central bank money securities settlement platform.

1.4 The EESC sees to the benefit of supplementing the existing Commission proposal with the provisions on recognition of T2S's central role for the European securities settlement infrastructure, while also solving, albeit partially, the issue of the underdevelopment of banking-type ancillary services among Central Securities Depositories (CSDs).

1.5 The EESC notes that the most controversial part of the proposal – the "two-step" approach to the potential imposition of mandatory buy-ins (MBIs) – remains a well-balanced option. MBIs should not be considered until underlying reasons for settlement failures are examined in detail and clarity is obtained on whether other measures to reduce settlement failures will achieve satisfactory results.

1.6 The Committee is fully aware that the Distributed Ledger Technology (DLT) Pilot Regime forms an important part of the legislative context of the CSDR review, while warning that the creation of a "regulatory sandbox" must not set a precedent for lowering existing standards of market conduct and investor protection. CSDs should play a key role in managing the DLT networks, defined in a way that reduces counterparty risk. Furthermore, the EESC advocates for stronger supervisory regulation for enforcing sanctions, suggesting that the CSDR should require CSDs, their issuers, and their participants to set up a viable, permanent mechanism to exchange and share data relevant to the application of common European sanctions.

2. Background

2.1 CSDs are entities that hold and administer securities and enable securities transactions to be processed by book entry[1]. CSDs operate the infrastructure which ensures that securities transactions can be completed. This main service of CSDs is usually referred to as "settlement". In the EU, existing CSDs[2] settle transactions worth well over EUR 1 000 trillion per year (more

1 Securities can be held in physical or dematerialised form.

2 There are 26 CSDs, plus two International CSDs. Source: ESMA Register.

than 70 times the gross domestic product of the EU[3] or 17 times more than the outstanding value of all securities held on CSDs accounts[4]). CSDs also provide other core services, such as (i) notary service, i.e. keeping track of newly issued securities, and (ii) central maintenance service, i.e. recording each change in the holding of those securities. For CSDs operating within national borders, well-tested and efficient procedures had existed for decades, but as markets became more interconnected and due to the increase in cross-border transactions in Europe, the need for harmonisation of cross-border settlement and other services became clear.

2.2 The 2014 Regulation, introduced after the 2008 financial crisis, entered into force on 17 September 2014, with a phased implementation[5]. This brought substantial improvements in the post-trading environment, including setting a standardised settlement period, improving cross-border settlement discipline, introducing consistent rules for CSDs in the EU (e.g. licencing, authorisation, supervision), and ensuring freedom for an issuer of securities to choose its CSD.

2.3 One of the main advances made in the Regulation concerned the settlement discipline – measures to prevent settlement failures and to address such failures, should they occur. However, as further assessment showed, these measures were not sufficient, as the EU settlement failure indicators remained considerably worse than those in other financial centres, even taking into account the highly fragmented nature of the EU capital markets compared with extremely homogenous markets elsewhere[6].

2.4 Another major improvement aimed at facilitating cross-border capital flows – the freedom to provide services in another Member State (or "passporting", similar to the well-functioning pan-EU framework for banking) – was also enshrined in the Regulation, providing impetus for CSDs to expand their activities across national borders. The provision of banking-type ancillary services (services that support securities settlement) by CSDs, while strictly complying with the specific prudential requirements for the credit risks related to those services, was also defined in the Regulation. However, the legal framework did not lead to the desired level of integration of the EU settlement services system, with CSDs reluctant to take on ancillary services or engage in a costly passporting procedure.

2.5 In March 2022, the Commission, acting in line with Article 75 of the Regulation that mandated a review, introduced a proposal reviewing the 2014 Regulation (hereafter referred to as the CSDR Review, or Review). This deals with the following five main issues:

(i) the burdensome requirements of passporting;

(ii) weak supervisory cooperation;

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3 Based on 2021 Eurostat GDP data, i.e. EUR 14.4 trillion.

4 At the end of 2020, there were over EUR 56 trillion worth of securities held in EU Securities Settlement Systems. Data generated through the ECB's Securities Trading, Clearing and Settlement Statistics Database. Accessed on 4 May 2022.

5 OJ C 299 04.10.2012, p.76

6 Settlement fails in equities, calculated as a percentage of the total number of transactions, fell to 3% before the COVID-19 market turmoil, but have since increased again to 4.5%. As a percentage of value, the ratio increased to 9% in January 2021 from 6% before March 2020. Source: Impact Assessment Report. However, market experience shows that majority of "fails" occur because the settlement instruction reaches the settlement system through the chain of intermediaries after the day designated by the end parties as "intended settlement day".

(iii) disproportionate requirements for providing banking-type ancillary services;
(iv) shortcomings leading to failed settlements;
(v) insufficient information on activities provided by third-country CSDs in the EU.

2.6 Almost simultaneously with the entry into force of the CSDR, but as a separate development, on 22 June 2015, T2S was launched as the first multicurrency central bank money securities settlement platform[7]. For clients (usually banks) of CSDs that are connected to the T2S platform, this means the ability to choose between Euro settlement in commercial bank money and/or in central bank money. By settling securities in central bank money via T2S, CSDs can offer their clients access to the single liquidity pool of the Eurosystem's TARGET Services for collateral, payments and securities settlement. Hence, the liquidity that is needed to settle transactions across Europe has been greatly reduced. However, this has had no impact on costs for a variety of reasons, but primarily because there is still market fragmentation across currency lines: in 2019, T2S fees went from 15 eurocents per "Delivery-versus-Payment" transaction to 23.5 eurocents[8]. T2S remains outside the scope of the Commission's March 2022 CSDR Review proposal.

3. General comments

3.1 As stated in the EESC opinion "A Capital Markets Union for people and businesses (new action plan)"[9], the Committee welcomes the Commission's initiatives to achieve the ambitious vision of the CMU, which is to enable capital to flow across the EU to the benefit of consumers, investors and companies. Of the 16 measures outlined in the CMU Action Plan, one of the most important is the improvement of cross-border settlement services (Action 13), as the shortcomings of the existing regulation are evident and swift legislative action is believed to push the CMU forward.

3.2 As to the five main issues identified by the Commission, leading to the Review, the Committee finds the proposed way forward to be sufficient and effective.

3.3 The proposal to replace existing **passporting requirements**, which are considered either unclear or burdensome, with a notification (meaning that Member States cannot refuse a CSD's application), is a major step towards a more harmonious and interconnected settlement system that will lead to a reduction in costs for CSDs willing to provide cross-border services. It remains to be seen, however, how these supportive measures will translate into cost savings for issuers and investors. Particular attention should be given to ensuring that supervisory authorities in host countries retain oversight of the market.

3.4 The need to reduce costs while improving **supervisory cooperation** led to the Commission proposal to establish supervisory colleges, which the EESC strongly supports as an appropriate, well-balanced measure. The Committee welcomes the introduction of only one college for the

7 TARGET2-Securities system. Currently 19 CSDs from 20 European countries are connected to T2S. The Danish krone has been available for settlement in T2S since October 2018.

8 Pricing of TARGET2-Securities system

9 OJ C 155, 30.4.2021, p. 20

CSD rather than two separate colleges, to ensure the CSD is not subject to the "passporting college" and the "group-level college" at the same time. This should save costs and help to achieve considerable supervisory synergies.

3.5 One of the main improvements to the framework of provision of **banking-type ancillary services** relates to the amendment of Article 54(4) of the Regulation, which the Committee strongly supports, as it allows CSDs to seek the provision of the aforementioned services, not only from designated credit institutions, but also from other CSDs.

3.5.1 However, the EESC recognises that this move could potentially increase financial stability risks. While the EESC sees merit in the objective of improving the provision of cross-border services as a result of lower barriers for the provision of banking-type ancillary services, and shares that aspiration, the Committee sees opportunities in solutions based on settlement in central bank money, which is inherently safer. Admittedly, this would need to be addressed largely outside of the CSDR – e.g. the expansion of T2S, the development of wholesale central bank digital currencies, the removal of legal barriers, etc.

3.5.2 It is, however, unclear whether the path chosen by the Commission to give a mandate to the European Banking Authority (EBA) to develop draft regulatory technical standards to define a threshold below which those banking-type ancillary services can be provided by credit institutions, is the appropriate one. On the positive side, the calibration of a threshold could be best performed by this Authority, and the Commission has greater room for manoeuvre if needed. Notwithstanding the above, the EESC has on various occasions[10] raised the issue of co-legislators being deprived of the power to decide on significant matters in the debated legislative act. The EESC therefore calls for important economic matters to be dealt with in an ordinary legislative procedure[11].

3.6 Steps to improve **settlement discipline** are extremely welcome. The Committee also supports the provision of clarifications and exceptions in multiple instances in the Review, related to the issue of settlement discipline. Of particular importance is the Commission's decision to avoid introducing MBIs immediately; these buy-ins could become applicable if and when the penalties regime alone does not improve settlement failures in the European Union. The introduction of pass-on mechanisms, which would prevent a cascade of mandatory buy-ins, seems to mitigate the underlying weaknesses (or the fear of sub-optimal application) of the proposed MBI regime. The Committee considers a "two-step" approach to MBIs a prudent one and believes that this way the European capital markets will become more attractive to both issuers and investors in the long run.

3.7 Provisions related to **third-country CSDs** are particularly important in the context of the EU's quest for open strategic autonomy. The EESC welcomes the requirement introduced in the amended Article 25 of the CSDR, which states that CSDs intending to provide settlement services under the law of a Member State should notify the European Securities and Markets Authority (ESMA). The Committee also supports the measures introduced by the Review which

10 Most recently, in EESC opinion on the Solvency II review, adopted in February 2022, see point 2.3.. OJ C 275, 18.07.2022, p. 45.

11 EESC opinion on the Solvency II review. OJ C 275, 18.07.2022, p. 45.

regulate other aspects of third-country CSDs' operations in the EU, thus leading to a level playing field and an environment of better competition.

4. Specific comments

Role of T2S

4.1 Given the considerable importance of T2S, the EESC is of the view that a coherent supervisory and oversight framework should be arranged in relation to this platform's role in the overall settlement system. Current voluntary agreements between the European Central Bank (ECB), the ESMA, national competent authorities (NCAs) of the CSDs participating in the T2S and the central banks overseeing the CSDs should be upgraded to ensure that the new legislative framework provides clear roles for all participating authorities: NCAs, the central banks and the ECB as lead overseers and ESMA as the supervisor. This enhanced framework could take the form of a college of supervisors.

4.2 Therefore, the EESC calls on the co-legislators to include the T2S systemic settlement platform in the scope of the CSDR and create the conditions for the widespread adoption of settlement via the T2S tool in the EU[12]. This is necessary to make this multicurrency system finally work to its full capacity, despite the understandable reservations of the central banks and CSDs in non-Euro countries. T2S's role in harmonising data and information flows – a crucial aspect for the effective provision of services by CSDs – should also be recognised and included in the legislative proposal.

4.3 Currently, T2S is monitored on the basis of a number of Principles for Financial Market Infrastructure included in the ECB oversight Framework – a "light" approach that recognises the systemic importance of this platform for the European Economic Area. The Committee sees no regulatory conflicts affecting undisputed ECB independence because T2S can be considered an infrastructure tool for financial market participants which, for a number of reasons, is better developed under the ECB's "roof" and not elsewhere. Moreover, the ECB's involvement in securities settlement via the platform is a step away from classic central bank functions, clearly leading to the need to include T2S in the CSDR to make a regulatory framework both coherent and effective.

Settlement discipline monitoring

4.4 The EESC notes that the most controversial part of the proposal – possible enforcement of mandatory buy-ins, carried out in a "two-step" approach – remains a well-balanced option to consider until clarity is obtained on whether other measures to reduce settlement failures will achieve satisfactory results.

4.5 The Committee believes, however, that addressing the issue sooner rather than later would lead to a better and deeper understanding of the reasons for settlement failure. The EESC therefore calls for the introduction of a set due date for the assessment of progress on settlement failure

12 Except for the Danish krone, no other non-Euro currency settlement can be carried out via the T2S system, as relevant actors outside of the Eurozone settlement are hesitant to join, and are adopting a "wait and see" approach.

indicators and of the underlying reasons for failure, in the form of a public report drafted by the competent authority, ideally within a 12-monts period after the entry into force of the penalties regime.

4.6 While some advocate the outright removal of the MBI obligation, the EESC is more cautious, in the light of unacceptably high (also in comparison to other major financial jurisdictions) settlement failure occurrences. The removal of a significant policy option from the Commission's toolbox would not make things better in this regard. The adoption of an implementing act appears to be a suitable option in this particular case.

4.7 The Committee acknowledges that there is a highly effective way of achieving swift decline in settlement failure figures – an increase in existing penalties until the right equilibrium is reached. Special attention should be paid to settlement failures involving "short selling" practices. MBIs could become a last-resort option, ready to be implemented extremely cautiously after appropriate consultations with market participants if everything else fails.

4.8 Before taking any action, particular attention should be given to measures aimed at shortening chains of intermediaries. Reasons for widespread use of the "pre-matching" technique require thorough examination. As many (technical) failures occur due to delays in long settlement chains, MBIs cannot be imposed without taking this factor into account and before implementing appropriate measures to encourage shortening of settlement "command chains".

Settlement in "digital assets" within a CSD's settlement system

4.9 The rise in "digital assets" has highlighted the functional interconnectedness of trading and settlement services in a given asset. The adoption of DLT, in the financial sector and elsewhere, offers huge potential. If trading and settlement in "traditional" assets is to remain competitive with trading and settlement in "digital assets", CSDs should be allowed to easily establish their own trading facilities for the instruments they settle the trades in. The Committee is fully aware that the DLT Pilot Regime forms an important part of the legislative context of the CSDR review. The Committee supports any change to the CSDR aimed at realising the full potential of DLT being postponed until the Commission proposal for the aforementioned pilot regime is adopted. However, as an interim measure, the Committee suggests the possibility of establishing a multilateral trading facility (MTF) for instruments that are settled within a CSD's settlement system. Maintaining an MTF should be considered an ancillary service within the meaning of Section B, part 1 of the CSDR's Annex.

4.10 The Committee warns that the creation of a "regulatory sandbox" must not set a precedent for lowering existing standards of market conduct and investor protection. Moving settlement processes entirely to DLT-enabled networks improves efficiency because it decreases the associated transaction costs and reduces involved risk when shortening the over-extended chain of intermediaries. Nevertheless, counterparty risk does not become obsolete just by leveraging DLT networks. It is crucial to ensure that the requirements for participation in these networks are defined in a way that reduces counterparty risk. CSDs should play a key role in managing the infrastructure.

Enforcement of sanctions

4.11 The CSDR Review comes at an extremely challenging time – in the midst of Russia's war against Ukraine. European financial market infrastructure was designed to be able to overcome shocks such as these; furthermore, the (systemically) important part of it – the network of CSDs – is now instrumental in ensuring that Western sanctions on Russia are properly implemented at the operational level. The EESC calls on the Commission to provide the necessary guidance in cases where actions related to sanctions enter "uncharted territories", leading to uncertainty among market actors. Certain provisions of such "quick fix" guidance may also be considered for use in further improving the Review proposal, making it more fit for future challenges.

4.12 Against the backdrop of international developments, the EESC suggests that the CSDR should require CSDs, their issuers, and their participants to set up a viable, **permanent mechanism** to exchange and share data relevant to the application of common European sanctions. The situation should not arise in which an action is omitted only because the different participants are not able to reach a conclusion that should otherwise be straightforward or at least achievable (i.e. if considered jointly). Whether the CSDR should be seen as an appropriate legal instrument for that is a valid question; nevertheless, the Committee advocates for stronger supervisory regulation for enforcing sanctions.

Brussels, 14 July 2022

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