

## **AFME Conference - May 16th 2012 - CSD Regulation**

In my 3 years in the European Parliament, working on the Economic and Monetary Affairs committee, most of the legislation I have found myself dealing with has been in some way instigated by the financial crisis.

Either coming as a consequence of the G20 in the case of EMIR and parts of MiFID, concerning the clearing and trading of derivative products, BASLE and the FSB in the case of the capital requirements directives and the much anticipated recovery and resolution plans as well as the bail in mechanism. Unlike the politically motivated case of the short selling regulation and the hedge funds directive, AIFMD. This is why I am enthusiastic about being rapporteur on the Central Securities Depositories dossier - a piece of regulation that finds its roots in the pre-crisis era, when EU financial services regulation was looking to remove the barriers to creating a single market in financial services across the EU in order to decrease costs for users and better facilitate access to the capital markets. The European CSD regulation being proposed should be informed by the events of the crisis but not created by it.

I'm sure many of you in the room remember initiatives on clearing and settlement from ten years ago - long before my time in the Parliament, looking at the findings of the CESME group, the identification of the 15

Giovannini barriers as well as introducing the Code of Conduct for Clearing and Settlement. The CSD regulation should be seen in the context of these proposals and not the financial crisis - as many CSD operators and market participants have told me - settlement systems and CSDs worked as they were supposed to during the peak of the financial crisis and beyond. To some extent however, this is what concerns me. As we raise costs for market infrastructure in other areas due to the concerns of systemic risk and financial stability, it becomes even more important that the rest of the post-trade space operates at peak efficiency. Necessary increases in costs should be paid for by decreases in unnecessary costs - as a British Conservative politician, no one in the room should be surprised to hear me say that I am in favour of efficiency savings.

For me, one of the key components of the CSD regulation is a harmonised regime for settlement periods. In order to fit 27 different jurisdictions together, one duration of settlement period is necessary. The Commission has made it clear that it believes T+2 is the most workable period, personally I believe that we should be aiming to shorten this period over time, however I have been convinced by the Commission's justifications that this is the best we can currently achieve. However this should be seen very much as a starting point and we should aspire to shortening this in the future.

Naturally I see the connection between T+2 and the other efficiencies that will be gained within those areas of the EU that are signed up to ensuring that Target2Securities finally becomes operational. I will not address this ECB project in detail - standing in a jurisdiction that is not currently signed up to join it, but I will say that I am committed to linking my work on the CSD regulation to that of T2S and will ensure that my regulation is not the reason for any further delays to the project.

The need for a common set of rules under which CSDs operate was proven to me when I read the responses to the first question of the Commission's consultation paper - "What is your opinion on a functional definition for CSDs?" As a starting point, defining precisely what we are talking about can't be a bad thing! Yet the multitude of answers that was received by the commission to this basic question made clear the sheer range of services that CSDs provide across the EU. When the European Association of Central Securities Depositories cannot provide on demand about which of the 40 CSDs operating in the EU currently provide which services, it seems logical to have a common rule book based upon common definitions. While I take no issue with different countries tailoring rules to fit the needs of their market place, including the UK issue relating to dematerialisation, I sincerely question whether there is

any logical or justifiable reason behind it when different CSDs don't even know what practices are taking place in other Member States, let alone what would constitute best practice.

This brings me to a perhaps unexpected issue raised and addressed by the commission's initial proposal namely settlement failure. Looking at the extensive and detailed rules concerning settlement fails, the measures aimed at addressing it ex-ante via incentive fee structures and the ex-post via sanctioning and a give-up mechanism, I was led to ask just how large a problem we are dealing with. To me an enforced give-up procedure for all circumstances seems quite far reaching legislation and would require justifying. Yet the question "how many settlement fails are there in the EU?" has rendered silence. And not for the usual reason that no one has compiled the data for commercial reasons, but because there seems to be no constituent definition of a settlement fail across the EU.

If financial supervisors in 27 member states cannot agree on this very basic concept then how can market users understand how they will be treated in each jurisdiction? It may be that the Commission's approach here seems harsh in a marketplace like the UK, that I am confidently told has very few settlement fails, yet if that is the case then the new rules will have little effect here and shouldn't be of any great concern. Although I

am open to the need to perhaps tailor them slightly to make them more proportionate.

One of the things I hope this regulation can achieve at least in part, is a resolution to an issue that for me stands at the heart of single market regulation - the problem of conflict of laws when it comes to cross-border security transactions. When I see the complicated web of intermediaries that stands between two counterparties in two different countries - sometimes running to 13 separate intermediaries, I can see why post-trade costs in the EU are astronomical in comparison to other jurisdictions. In order to reconcile and consolidate that complicated chain of financial institutions - and their considerable legal teams - the conflicting legal systems and laws of Member States needs to be overcome. While this is primarily the task of the Securities Law Directive, due at the end of this year, we can start the process within the CSD regulation of getting Member states to accept a compromise that would deliver legal certainty to market participants.

As an MEP rather than a national politician I really feel it is my role in this area not to advocate one solution or legal system over another, but to deliver this final objective of legal certainty through a single rule book for settlement.

When engaging in a transaction, market participants should have a right to know where their money is during the whole process of a transaction. The failure of brokers to properly segregate client accounts in the case of the collapse of MF Global should have focussed regulator's minds to the needs of clients, particularly if they request to be offered the highest level of segregated accounts for their assets throughout the entire post trade chain. Should one of those links break it should not take a team of lawyers and auditors over a year to tell you where your money is.

As such, I am really glad that the latest internationally agreed standards, published by CPSS-IOSCO last month, clearly recommend that CSDs should "segregate participants securities from those of other participants through the provision of separate accounts." It is my belief that the Commission's method of defining individual segregation with words like "distinguish" simply does not go far enough. "distinguishing in records and accounts" leaves too much room for interpretation at the expense of the end client. At a bare minimum, fully segregated accounts should be offered, at cost, to those who would like the extra safety.

I was pleased to see that the vast majority of the CPSS IOSCO standards are in fact reflected in the Commission's proposal - the fact that the EU is

looking to integrate 27 different, hugely divergent systems already, must help when they sit in international fora like IOSCO.

The work done here on resolution plans and contingency planning for CSDs seems well thought out. I may think that CSDs and settlement systems operated well during the crisis, but any piece of infrastructure that processes 920 trillion euros in one year clearly needs provisions to be made for the case that one - or in deed many - fails. Being prepared for that failure so it does not have a cataclysmic effect is a new part of the work that both financial market infrastructure providers and financial market supervisors must undertake together. I hope that these new international standards will encourage them to put together plans that will never have to be used.

There are two major aspects to the CSD proposals that cross into many of the other pieces of EU financial regulation namely that of access to market infrastructure and that of engagement with the outside world, the so-called third country issue. In the European Parliament we have looked at these 2 issues in EMIR, MiFID, AIFMD, short selling, Solvency II, Credit Rating Agencies - the list goes on and on. Yet I am still not happy with any of the outcomes- to date there is still no successful template that

anyone can point to for resolving these issues. A problem compounded by the seemingly extra territoriality of the Dodd Frank Act.

When the EU is trying desperately to find ways to return to growth, the very idea that we are discussing such issues as strict equivalence and reciprocity, setting up barriers to people investing in the EU is nonsensical. We are lucky enough to have the only 2 ICSDs globally located in the EU, we should not be creating barriers to their usage or operations in the immediate future. One of the things that has tried my patience the most in the past few years, is the broken up, piece meal approach we have taken to dealing with the third country issue. I still live in hope that in two years time, when no one outside of Switzerland has met the equivalence requirements of the AIFM, and no G20 regime even the US has met the strict equivalence of EMIR, that the Commission will come forwards with one harmonised omnibus proposal that sets out a real workable approach to the EU's dealing with the rest of the world.

Keeping straight all of the acronyms and different regulations and procedures required may make great jobs for lawyers but it is not going to help the flow of capital we need from the rest of the world to finance other jobs and the rest of the economy.



Returning to the issue of access, instead of criticizing the Commission and the rest of the EU's legislative process, I'd like to level my criticism the other way. When the Commission looked at the problems found across the EU Member states with access to market infrastructure, instead of introducing draconian legislation to force the market open in one big bang, they took a softer approach - The Code of Conduct on Clearing and Settlement. This was signed up to by the Federation of European Stock Exchanges, the European Association of Clearing Houses and the European Central Security Depositories Association in 2006 - my favourite phrase in the code being "to make the concept of "cross border" redundant for transactions between EU Member States". The Code of Conduct was supposed to be a market led solution to the problem of certain parts of the market not allowing non-discriminatory access to other pieces of infrastructure, of the bundling of fees and of the general lack of price transparency. Yet 6 years later, while some progress has been made, it has barely been noticed in terms of the cost of post trade services. AS such, I am fully supportive of the need to formalise some of the principles that were in the Code of Conduct into this CSD regulation - perhaps that will provide a final push to the market to offer a more competitive environment for their operation to take place, where they can truly listen to the needs of their users and benefit the entire market.

My comments today have hopefully not come as a surprise to you, and by way of reassurance I can let you know that we are still near the beginning of the legislative process, and most of what I have said should be taken as my own view so far. To explain a little bit about how the rest of the process works, I intend on writing my report as the Parliament's rapporteur, which will amend the Commission's proposal by the middle of July, then present this to the Economic and Monetary Affairs committee in the Parliament on the 20th September. At that point, the rest of the ECON committee will amend my text and the text of the Commission, submitting their views by the 18th October. At that point each of the political groups will appoint a shadow rapporteur to represent their views of their group in negotiating one compromise text that will be put to the vote, hopefully on the 18th December. In parallel to this, the Council of Ministers, made up of the 27 Member States, conduct a separate process, also amending the Commission's text and finally coming to a General Approach in one consolidated text. The final step in the primary legislative process involves the Parliament, led by myself, the Council, led by the Council's rotating Presidency which will be Ireland by Jan 2013, and the Commission, coming together in what is called a trialogue, to fight out each issue and come to a final agreement line by line on the legislation. In my experience, sometimes this can be a straightforward alignment of texts when Council and Parliament are not

particularly far apart, usually when the Commission has come forward with a solid proposal. However sometimes it can be an arduous, drawn out affair - I think the longest single triologue I have ever attended lasted over 13 hours - and took two more three hour sessions to finally agree the legislation! As such, I would hope to complete triologue before summer next year, allowing ESMA to write the technical details of the proposal in the second half of 2013 leaving an implementation date of some point in 2014.

Many of you who have heard me speak previously will know that I have a reputation for asking for data, and in fact, in my speakers note today, one of the things that AFME asked me to address was "what kind of information and input do you require from industry?" The answer is open. I am very open to receiving comments and suggestion on this issue. The "Regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC" covers many complicated issues. You know your industry better than I do, so you should be able to tell me what I need to do to ensure a safe, efficient and competitive model for settlement within the EU.

Are there exceptions that need to be made to the T+2 proposal? Is settlement failure really a problem? Is there any quantifiable reason why dematerialisation or immobilisation of shares shouldn't be progressed towards rapidly? What are your views on the provision of banking services by CSDs? - a huge issue that I would really like to hear more views upon, who should own a CSD? How interoperable do we want CSDs to be? Is securities lending an issue? Should we constrain rehypothecation and is account segregation really necessary? And a final question - what have we missed?

The process of EU regulation is often accused of being opaque and seen as something that is done to the industry by mandarins from their ivory towers in Brussels. As should be clear from my presence here today, and the presence of Patrick Pearson from the Commission and Verena Ross from ESMA on the regulatory panel later, the whole process is interactive. We want to hear what you think so as to make the regulation work. For me, the best solution is one that can be accepted by politicians, regulators, market infrastructure providers, and users from both the buy and sell side. But most importantly, a solution that reduces the costs of investing in Europe and allows the capital markets to provide the financing we need to fuel growth and jobs for the rest of the economy for the foreseeable future.