
Briefing Note

AFME Position on non-SDR Priorities for the CSDR Review

October 2021

Introduction

In July 2021, the European Commission published a report on the Central Securities Depositories Regulation (CSDR).¹ AFME members broadly agree with the conclusion of the report, that CSDR is, in most areas, functioning effectively and achieving its objectives. We also agree that certain targeted interventions should be considered to ensure the regulation achieves those objectives in a proportionate, efficient and effective manner.

As highlighted in our consultation response in February 2021², AFME considers amendments to the settlement discipline regime (SDR), in particular the mandatory buy-in rules, as the most urgent and important priority of the CSDR Review process.

The purpose of this paper is to share our views on other elements of CSDR which were identified in the European Commission report as areas where further action may be required. This paper is organised in alignment with the five³ principal issues highlighted in the report.

Issue 1: Clarifying and simplifying burdensome requirements related to the provision of services by CSDs domestically and cross-border

AFME's longstanding vision is for a harmonised and standardised operational, legal and regulatory environment in which CSDs can compete to offer innovative and low-cost services to all users on a non-discriminatory basis. As acknowledged by the European Commission, a core objective of CSDR is "the creation of a single market for CSDs."

Delivering on this ambition, and creating competitive and efficient EU capital markets, is dependent on driving competition from the point of issuance. That is to say, in a true single market for CSDs, geographical location of the CSD should not be the principal driver of an issuer's choice of CSD.

To a large extent, we do not believe that this has been achieved. There is not true competition amongst CSDs for the provision of issuance services. We note that ESMA's report⁴ on the cross-border provision of CSD services, in November 2020, concluded that, notwithstanding ICSDs, most EU CSDs "dedicate less than 5% of their notary and central maintenance activity to securities issued by issuers from other Member States".

On that basis, we are supportive of targeted action by European authorities designed at promoting increased competition amongst CSDs, in particular to remove barriers to cross-border issuance, including the simplification of passporting rules under CSDR. AFME believes that the passporting process under CSDR, as set out in Articles 23 and 49 of CSDR, is significantly more complex and burdensome than equivalent passporting processes in other pieces of European legislation.

¹ https://ec.europa.eu/info/publications/210701-csdr-report_en

² https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME_CSDR_CP_Response_Final.pdf

³ Notwithstanding Issue 4.4 – reducing disproportionate burdens and costs related to Settlement Discipline

⁴ https://www.esma.europa.eu/sites/default/files/library/esma70-156-3569_csdr_report_to_ec_-_csd_cross-border_services.pdf

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Further to this, there are significant and longstanding barriers that inhibit the effective ability of CSDs to provide cross-border services. Addressing these barriers will require legislative intervention beyond the scope of CSDR.

These obstacles include national-level divergences in the following areas:

- Issuance processes and requirements
- Corporate law requirements
- Processes for the attribution of corporate action entitlements

On this last point, we note that many national processes for the attribution of corporate action entitlement are, *prima facie*, inconsistent with Article 3 of CSDR.

To make significant improvements in these areas will require, *inter alia*, that the proposals of the European Commission's Action Plan on Capital Markets Union are put into effect. Most relevant are Actions 10 (promoting a standardised system for withholding tax relief at source) and 12 (a harmonised EU-definition of 'shareholder', and further clarification and harmonisation of corporate action processing).

In addition to legislative changes, AFME believes there is scope for further development of pan-European market practices. In this context, the work of European Central Bank groups, such as the T2S DIMPG and Corporate Events Group, can be important drivers of the creation and monitoring of market standards.

Issue 2: Improving supervisory convergence amongst authorities involved in CSDs' supervision

In July 2020, The High-Level Forum on Capital Markets Union⁵ recommended that the CSDR review should seek to strengthen supervisory convergence amongst national competent authorities (NCAs). AFME fully supports this recommendation.

Current supervision arrangements are complex and fragmented. Increasing supervisory convergence will help to ensure a level-playing field.

We wish to highlight that such measures may be beneficial to achieving other objectives of CSDR. For example, the differing application of CSD rules directly impacts the cross-border provision of services. Further supervisory harmonisation would help ensure consistent application of CSD rules, including for the approval of passports. Current CSD passporting arrangements require approval from the relevant home state NCAs into which the CSD will provide services. A college of supervisors may provide a balanced and consistent approach which may accelerate such approvals.

Issue 3: Facilitating the provision of banking-type ancillary services

AFME recommends that any changes to current rules should not result in a relaxation of the prudential requirements⁶ applicable to CSDs wishing to provide these services. We note that CSDs, at their core, perform a critical market infrastructure function which should be protected from the additional risks that may arise from undertaking banking services.

Indeed, the path forward should be designed towards reducing risk.

⁵ https://ec.europa.eu/info/sites/default/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf

⁶ as per the regulatory technical standards defined in the Commission Delegated Regulation (EU) 2017/390

Wherever possible, settlement in central bank money should continue to be encouraged. However, there is a clear need to support settlement in commercial bank money in cases where central bank money is not available, for which appropriate prudential rules are required.

Rather than relaxing such rules, authorities should consider alternative options such as facilitating greater access to central bank money for non-domestic CSDs including, where possible, through tokenised representations of central bank money.

AFME considers that the proposal from the European Commission to allow CSDs with a banking license to provide banking services to participants in other CSDs is problematic. This is a path towards increasing risk, rather than towards reducing risk. Fundamentally, and for reasons of systemic risk, CSDs should not be banks. Current exceptions exist for pragmatic reasons and under strict and limited conditions. Any proposal to extend the scope of these exceptions will ultimately increase the risk of contagion.

Issue 4: Enhancing the framework for third-country CSDs

AFME notes the concern of ESMA⁷ that little public information is currently available as to whether third country CSDs engage in settlement services for EU securities. AFME would support targeted and proportionate measures to improve the public availability of this information.

We wish to note our concern with ESMA's suggestion to extend the scope of the third-country CSD recognition regime to also cover settlement services. We note that any third country CSD holding EU securities necessarily provides a form of settlement services for those securities.

Expanding the requirements placed on third country CSDs may prevent third-country CSDs from holding EU securities, and may hinder EU market participants from holding accounts with, or accessing, third-country CSDs. Both such developments would damage EU securities markets. Expanding the requirements placed on third-country CSDs may also lead to other jurisdictions imposing equivalent recognition requirements, which would negatively impact EU (I)CSDs who currently facilitate the settlement of third-country-issued securities.

AFME supports as a matter of principle the end of grandfathering of CSDs under CSDR. This is on the grounds that sufficient time has passed, and that it is desirable that all CSDs comply with the definitive CSDR regime. The end of grandfathering is, however, dependent on the definitive CSDR regime being appropriate. Inappropriate changes to the definitive CSDR regime would create a need for grandfathering.

Issue 5: Use of technological innovation

AFME members generally consider that CSDR is technology-neutral, but certain definitions could be amended to clarify that DLT-based solutions are permissible.

We believe that it is probable that more barriers will be identified during the course of the DLT Pilot Regime, and therefore there should be opportunity for further amendments to CSDR, to continue supporting emerging technologies.

It will be important to ensure ongoing dialogue between policymakers, regulators and industry to support the efficient identification of these issues, ensuring the regulatory framework is agile and adaptable to market developments.

7

Where barriers to the use of DLT have already been identified in CSDR, we recommend that action should be taken immediately to address these – e.g. through Q&As published by ESMA, or amendments to CSDR as part of the review process. AFME supports the conclusion of the ESMA report on the use of fintech by CSDs, which identified a number of areas where clarification would be beneficial.

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- *Whether digital addresses held in a DLT platform can be considered “securities accounts”;*
 - *Whether data recorded to a DLT platform can be considered as “credits” and “debits” within the meaning of CSDR;*
 - *Whether segregation requirements under Article 38 of CSDR would be respected when segregated records are maintained on the DLT platform enabling the identification, at any time, of the assets that belong to a particular client, distinct from another client’s assets or from the CSD’s own assets.*
 - *Whether reconciliation measures under CSDR can be satisfied through real-time data sharing on DLT ensuring that the integrity of the issue is preserved (the number of issued securities is equal to the sum of securities recorded on the DLT).*
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We note that potential changes should be considered in the context of the review of the Settlement Finality Directive (SFD) and recommend that amendments to CSDR and SFD are designed holistically, given the interaction between the two regulations.

AFME supports the objectives of the EU DLT Pilot Regime to promote competition and innovation in the securities settlement space. We recommend that regulators and policymakers consider how to implement these changes more permanently in the regulatory framework, in order to embrace the opportunity for transformational changes to the post-trade ecosystem. In other words, the vision for the future of capital markets should not be limited to maintaining the same market structure (and accompanying roles, responsibilities and relationships) as today.

In particular, it should be considered whether the core functions currently performed by CSDs need to be centralised at an FMI-level, or whether some of these functions can be performed in a different way, for example by leveraging the potential of DLT to create flexible and resilient networks, where different actors can perform one or several functions, without the need for a single central entity. The network itself would clearly need to be regulated to ensure resilience but can support further innovation and competition in the current market structure.

AFME considers that the development of regional and global standards is critical to the development and adoption of DLT-based solutions. As noted in the ECB’s report on the use of DLT in post trade processes⁸, existing DLT systems diverge in a number of ways. Ensuring interoperability between different platforms will be required, which requires common rules or standards (e.g. on communication protocols.)

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⁸ https://www.ecb.europa.eu/pub/pdf/other/ecb.20210412_useofdltposttradeprocesses-958e3af1c8.en.pdf