EACB position on the consultation by the Commission Services Central Securities Depositories (CSDs) and on the harmonisation of certain aspects of Securities Settlement in the European Union

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EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eurocoopbanks.coop • e-mail : secretariat@eurocoopbanks.coop

General remarks

The European Association of Co-operative Banks (EACB) would like to thank the European Commission for the publication of its thoughts on possible legislative steps concerning Central Securities Depositories (CSDs) and on the harmonization of certain aspects of securities settlement in the European Union.

You can find our detailed comments on the individual questions outlined in the consultation paper below.

PART I APPROPRIATE REGULATORY FRAMEWORK FOR CSDs

1. Scope and definitions

1.1. Personal scope and exemptions

Q1. What is your opinion on a functional definition of CSDs?

European co-operative banks are supportive of a functional approach concerning the definition of a CSD, especially concerning the core and ancillary services. Only the combination of the definition of core services with the operation of a securities settlement system delivers the basis needed to limit the scope of the addressees.

Q2. What is your opinion on the scope of the possible legislation and providing for any exemptions (such as for central banks, government debt management offices, transfer agents for UCITS, registrars, account operators)?

In order to ensure a level playing field it is important to avoid exemptions from the scope as much as possible. We see no basis for granting exemptions from the CSD-legislation to issuer type market participants such as government debt management offices or transfer agents that have chosen to provide CSD services themselves. According to the Commission services, safety and efficiency are the main goals of the envisaged regulation. It should therefore apply equally to all CSD operators regardless of their ownership or company structures.

1.2. Definition of CSD services – Background

1.3. Core CSD services

Q3. What is your opinion on the above description of the core functions of a CSD?

The definition of CSD functions appears appropriate, given that substantive legal issues raised by the transfer of ownership are to be dealt with by the Securities Law Directive. The EACB believes that the notary, safekeeping and settlement function should be core to a CSD. The focus of a CSD should be on these activities and its business model should be low risk. More banking type of activities do not fit in this market infrastructure low risk model.

To differentiate more clearly from other service providers, the notary function referred to in section 1.3. (1), which does not necessarily have to be performed "*in a specific account in the name of the issuer*", could be worded as follows: "*Admission of securities*

of an issuer for the purpose of central referential recording, clearing and settlement of book-entry credits on securities accounts (notary function), including maintaining the integrity of the issue."

Q4. Which core functions should an entity perform at a minimum in order to be qualified as a CSD?

It is generally sufficient for qualification as a CSD for an entity to perform one of the three core services mentioned in combination with the operation of a securities settlement system as per the Settlement Finality Directive (SFD).

Q5. Should the definition of securities settlement systems be reviewed?

We fully support the proposed definition for the reasons given in the consultation paper.

1.4. Ancillary CSD services

Q6. What is your opinion of the above description of ancillary services of a CSD? Is the list above comprehensive? Do you see particular issues as to including one or several of them?

Because of CSDs' importance for the securities markets, limiting the range of services they provide basically makes sense. We concretely support the concept of requesting CSDs to adopt a low-risk business model, of requesting ancillary services to have a clear connection with core services, of taking into account the activities of existing CSDs as long as they are in line with the above principles, of not introducing an exhaustive list of ancillary services but allowing the list to evolve in compliance with the above principles and of dividing up ancillary services into six defined categories, as proposed. Largely "risk-free" services should continue to be allowed, however. We therefore welcome the final bullet point under section 1.4., which states that any list of ancillary CSD services "*should not be exhaustive but flexible*".

2. AUTHORISATION AND ONGOING SUPERVISION OF CSDS

2.1. Background

2.2. Domestic and non-domestic activities of a CSD

Q7. According to you, could the abovementioned cases impact a future regime of authorisation and supervision? Yes? No? No opinion? Please explain why. Are there other cases which could have an influence on a future regime of authorisation and supervision?

We fully support the basic principle that an entity wishing to perform CSD services should be subject to an initial authorization and proper supervision. Where a CSD has a cross-border business model, we are in favour of only involving the supervisors whose markets are directly affected (home/host regime) – an approach which should also be in line with the status quo.

We also agree to apply the principle of "subsidiarity" according to which only business with a potentially external impact would call for an authorization and supervision regime encompassing authorities of all Member States involved.

The definition of "external" appears very broad to us. For example, the first business case is likely to apply to many CSDs, which would thus be deemed to be operating cross-border. The "*participation of a member from a different jurisdiction*" (second business case) describes what is, in our view, standard remote access practice. This and "*settlement in a different currency*" (sixth business case) do not, on their own, justify supervision going beyond national borders. A foreign supervisor should only be involved if "genuine" CSD services are performed in this market.

2.3. Initial authorisation procedure

Q8. What other elements should be submitted as part of the initial application procedure by a CSD?

We agree with the envisaged elements of an initial authorisation procedure. No other elements need to be added to the procedure for initial authorisation of a CSD in our view.

Q9. According to you should the authorisation procedure of a CSD be distinct from the designation and notification procedure under Art. 10 of the SFD? Yes? No? No opinion? Please explain why.

We believe that the authorization procedure of a CSD should be distinct from the designation and notification procedure under Art.10 of the SFD, because providing the settlement function is only one potential core service a CSD may provide, but should not be forced to provide, and because most CSDs have already concluded the procedure under Art. 10 of the SFD.

2.4. CSD Register and temporary grandfathering

Q10. What is your view on establishing a register for CSDs?

Such an ESMA-operated, up-to-date register would be suited to providing an overview of CSDs and the range of services they perform. It would therefore increase transparency and should be welcomed.

Q11. What is your view on the above proposal for a temporary grandfathering rule for existing CSDs?

We support the idea of temporary grandfathering so as to put CSDs in Europe on a uniform legal footing. Should further services be provided in line with the new regulation, we consider a requirement to report to the competent supervisor as adequate. The competent supervisors and their interaction are questions that should be examined separately in this connection.

2.5. Capital requirements

Q12. According to you, does the above approach concerning capital requirements, suit the diversity of CSDs? Yes? No? No opinion? Please explain why.

We fully support the approach that regarding the minimum capital requirements a calculation method should be applied.

2.6. Supervision

Q13. According to you, should the competent authorities have the above mentioned powers? Yes? No? No opinion? Please explain why.

We agree that the competent authorities should have the powers mentioned in section 2.6 with the exception of the power to review strategies implemented by CSDs (3rd bullet point), as these are not regarded as relevant to perform the tasks of supervision.

2.7. Licence (passport regime)

Q14. Would a special purpose banking license be appropriate for "banking type services"?

No. Since a CSD should be authorised to provide core services as defined in our answer under Q3, a special purpose banking license is neither appropriate nor necessary.

Q15. Which of these three passporting options would you support? Full passporting? Limited passporting? Opt out regime? Please explain why.

We support a limited passport. This ought in our view to take due account of the level of protection of market participants in the Member States and ensure legal certainty with regard to the custody and management of securities. The supervisor of the host Member State should have the possibility to decide whether the foreign CSD satisfies the capital, licensing, etc. requirements that it sets. This follows from the distinction between core and ancillary functions of a CSD, which should be reflected in differentiated requirements for the licence needed in each case.

3. ACCESS AND INTEROPERABILITY

3.1. Background

3.2. Access of market participants to CSDs

Q16. What is your opinion about granting a right for market participants to access the CSD of their choice?

We believe that it is appropriate and necessary for rights for market participants to access CSDs to be addressed in future regulation so that all market participants have unrestricted access in future. At the same time, we wish to point out that this right of access can often only be exercised to a limited extent in actual practice.

Practitioners face the following problem: it is right that all CSDs/SSSs are given the possibility via TARGET2 interfaces defined by the Eurosystem to use foreign remote access participants' account with their national Eurosystem central bank for cash settlement in euros of securities transactions with them. However, since foreign banks have no access to central bank credit facilities and because of the requirement for CDSs/SSSs in their general terms and conditions of business to accept only national central bank accounts, remote access participants in a CSD/SSS face additional cash-side barriers.

3.3. Access of issuers to CSDs

Q17. What is your opinion on the abolition of restrictions of access between issuers and CSDs?

We fully support the aim of abolishing restrictions for issuers wanting to „export“ a security to an non-national CSD and for CSDs wanting to “import” securities from a non-national issuer. We welcome the integration of the European Internal Market which, by creating more competition between CSDs, should enable a country to manage without a CSD of its own.

To accomplish this, the removal of Barrier 9 is, on its own, not enough. The following points must be taken into account at the same time in order to avoid legal uncertainty and thus systemic risk. In addition, the distribution of costs between issuers and CSD participants should be clearly regulated:

- The successful removal of the Giovannini barriers in corporate actions processing.
- A sufficiently clear distribution of infrastructure operating costs between issuers and CSD participants, especially for registration functions.
- Despite freedom of choice, a CSD/registrar remains the sole provider of the notary function for remaining issues. This means that there are still considerable fixed costs. These would have to be borne primarily by issuers, CSD members and thus ultimately by investors as custody charges which may then increase significantly.

Q18. According to you, should the removal of Barrier 9 be without prejudice to corporate law? Yes? No? No opinion? Please explain why.

In some European jurisdictions – like in Germany – the removal of Barrier 9 would lead to changes in the corporate law.

Q19. How could the integrity of an issue be ensured in the case of a split of an issue?

Legislation should explicitly state that in case of a split of an issue every CSD providing the notary function for a split issue is liable for the fraction of the issue for which it performs the notary function and that all CSDs providing the notary function for a split issue have to enter into an interoperability agreement for the purpose of introducing procedures for realigning the fractions of the issue at least once a day.

3.4. Access and interoperability between CSDs

Q20. What is your opinion on granting a CSD access rights to other CSDs and what should their scope be?

It should be made clear what is meant by interoperability. Assuming it to mean the links between CSDs, we support the freedom of CSDs to organise and operate these links according to the needs of the relevant markets. However, right of access to and between market infrastructures should be provided on a non-discriminatory basis. Furthermore, right of access by other market participants (e.g. banks) to market infrastructures should be on the same fair and non-discriminatory access as right of access between market infrastructures.

3.5. Access between CSDs and other market infrastructures

3.5.1. Access to CSDs by CCPs

3.5.2. Access to CSDs by trading venues

Q21. What is your opinion on a CCP's right of access to a CSD?

Rights of access should be non-discriminatory, but also make economic sense.

Q22. What is your opinion on access conditions by trading venues to CSDs? Should MiFID be complemented and clarified? Should requirements be introduced for access by MTFs and regulated markets to CSDs? Under what conditions?

Rights of access should be non-discriminatory, but also make economic sense. If addressed in the CSD regulation, these should be consistent with the current MiFID Review in regard to the definition of “trading venues”. We see no need for special requirements or conditions.

3.5.3. Access by CSDs to transaction feeds

Q23. According to you, should a CSD have a right to access transactions feeds? Yes? No? No opinion? Please explain why.

We see no need for additional regulation.

Q24. What kind of access rights would a CSD need to effectively compete with incumbent providers of CSD services? Should such access be defined in detail?

We see no need for additional regulation.

4. PRUDENTIAL RULES AND OTHER REQUIREMENTS FOR CSDS

4.1. Background

4.2. Legal framework

Q25. Do you think that the legal framework applicable to the operations performed by CSDs needs to be further strengthened?

Aspects concerning the legal effectiveness of operations involving holdings of securities by intermediaries should be a matter for the Securities Law Directive. Requirements relating to insolvency law, particularly for CSDs, should be closely coordinated with principle 10 of the consultation document on the Securities Law Directive. It is important to avoid duplicating or contradicting requirements in other legislative instruments. We therefore see no need for further regulation.

Q26. In particular should all settlement systems operated by CSDs be subject to an obligation of designation and notification?

No comment.

4.3. "Securities lending" to tackle pre-settlement risk

Q27. What do you think of the general elements of these requirements, particularly with respect to the obligation for CSDs to facilitate securities lending and the obligation of counterparties to securities loans to put in place adequate risk controls?

The use of deposited securities as a collateral pool for securities transactions should remain an optional function for CSDs. We support the general elements of the proposed requirements and especially welcome the fact that the choice between centralised and bilateral facilities will be at the discretion of each market.

4.4. Book entry form

Q28. What do you think about the requirement for issuers to pass their securities through a CSD into a book entry form? If such an obligation were considered, which securities should it concern? Only listed securities? All securities with an ISIN code? Only equities? Eligibility approach?

We think that issuers should have the free choice to have their securities account-held. If they decide to have their securities account held they should be obliged to entrust the securities at the top tier safekeeping to a CSD ("notary function"). These securities which are held collectively could be in certificated form, represented by a global certificate or dematerialised (created in a register). It is up to future legislation regarding a Securities Law Directive ("SLD") whether the booking of these securities will create "book-entry securities" with which certain rights will be connected (see Second Advice and the consultation process for a SLD). Since any issuer could opt to have its securities kept by a CSD, the respective CSD must be obliged to ascertain that the securities have been validly issued.

Q29. What is your opinion with respect to grandfathering ?

We would like to point out, that it needs not necessarily to be the issuer of the securities that may decide to have "its" securities account-held with a CSD, but anybody who owns a number of securities of the same description could decide to introduce them into the bookkeeping system of the CSD (e.g. in case offering and sale of these securities is intended).

4.5. Delivery versus Payment (DVP)

Q30. What do you think about the requirements above for DVP? Do you see any issues in respect of the different DVP models?

We believe the suggested principles for ensuring DVP would reduce settlement risk. In our view, however, this issue is already adequately regulated in the Settlement Finality Directive. A duplication of requirements should be avoided. DVP may also be ensured by the planned European Target2-Securities (T2S) settlement platform. This point should be clarified.

Q31. What are your particular views on the grandfathering principle coupled with the requirement for the introduction of a guarantee fund?

The EACB opposes the creation of a guarantee fund. If a precaution is deemed as necessary, which we question, it would be more appropriate to impose the costs of a precaution (insurance) to the CSD operating the system as this will create an incentive to change the settlement system to DVP.

4.6. Settlement of the cash leg in central or in commercial bank money

Q32. What do you think about a preference of settlement in central bank money? Should such a preference be applied equally to all types of securities?

We think that CSDs should always offer settlement in central bank money but should also be allowed to offer in addition settlement in commercial bank money. As stated, it should be the choice of the account holder to either use central or commercial bank money in case both are offered.

Q33. Do you think that the principles outlined above could be transposed in future legislation?

Yes.

Q34. What is your opinion about the extent of the requirements that should be imposed when commercial bank money is used?

The principles set out in the consultation document are sufficient. We see no need for further requirements.

4.7. Reconciliation and protection of customers' securities

Q35. What do you think about the rules above?

We support these rules, which we believe reflect current standard practices.

Q36. Are further rules needed in order to ensure reconciliation and segregation?

No.

4.8. Operational risk controls

Q37. Do you think that these six basic principles cover sufficiently operational risks?

The six basic principles are sufficient, in our view. Details of the principles should be fleshed out in secondary legislation. We believe it will be important to ensure with respect to the penultimate bullet point that the “minimum operational requirements for its participants” established by a CSD are strictly confined to requirements relating to the interface with the CSD.

4.9. Governance

Q38. What do you think about the eight principles above, particularly with respect to board composition and the need for a risk committee?

These 8 principles are a good step into the right direction.

4.10. Outsourcing

Q39. According to you, should CSDs be subject to a principle of full responsibility and control on outsourced tasks? Yes? No? No opinion? Please explain why.

We believe that CSDs like any other account provider should be subject to a principle of full responsibility and control on outsourced tasks.

Q40. Should there be any other exemptions from the principle of responsibility and control of CSDs on outsourced tasks?

There should be no exemptions.

4.11. Financial risks directly incurred by CSDs

Q41. What is your opinion on the above prudential framework for risks directly incurred by CSDs?

CSDs that provide banking services should have an appropriate banking licence and will consequently be subject to the requirements of the CRD and its technical interpretation by CEBS. We believe the definition of a CSD should be primarily based on the provision of core services and thus, as indicated in section 4.11. (b), a "*system*" pursuant to the SFD. This means banking services could only be offered in a very limited way because a CSD should mainly bear operational risks and not credit risks.

We wonder what the consequences are of a CSD having to buy in missing securities. This creates substantial potential exposure (for example when a linked CSD of custodian goes into insolvency) which contradicts to the low risk business model. Because of its market infrastructure function it could even cause systemic risks.

4.12. Credit risk controls when CSDs act as facilitators

Q42. What do you think about the principles above?

Referring to Q 41, we think that granting credit should not be a service a CSD should provide. This means this should be done by a separate legal entity with a (distinct) banking license.

4.13. Price transparency and service unbundling

Q43. What do you think about including these elements of the Code in legislation?

Price transparency is highly important for users. This will apply all the more when the new T2S platform starts to handle securities settlement for CSDs. We believe, moreover,

that not only price transparency, but also price comparability should be facilitated on the basis of standardised definitions of services in CSDs' schedules of charges. Details of discounts should also show all benefits which are granted (e.g. different interest rates for credit/negative balances).

PART II: HARMONISATION OF CERTAIN ASPECTS OF SECURITIES SETTLEMENT IN THE EUROPEAN UNION

Q44. According to you, is the above described harmonisation of key post trade processes important for the smooth functioning of cross-border investment? Yes? No? No opinion? If yes, please provide some practical examples where the functioning of the internal market is hampered by absence of harmonisation of key post trading processes. If no, please explain your reasoning.

We support the idea of addressing the issues mentioned and would welcome the Commission moving forward discussions in these areas. Top priority should be given to the harmonisation of settlement cycles (section 6), in our view, especially given that work by the Harmonisation on Settlement Cycles Working Group (HSCWG) established by the Commission for this purpose is already well advanced.

Q45. Do you identify any other possible area where harmonisation of securities processing would be beneficial?

We would recommend that the identification of such areas should be based on the findings of the work on T2S (Advisory Group meeting on 6-7 December 2010, item 7).

5. SETTLEMENT DISCIPLINE

5.1. Background for improving and harmonising settlement discipline

5.2. Definition of settlement fails

Q46. According to you, is a common definition of settlement fails in the EU needed? Yes? No? No opinion? Please explain why. If yes, what should be the key elements of a definition?

Against the backdrop of our answer 47, we believe a common definition used by market/CCPs and OTC contract counterparties could be helpful in order to clarify exactly what constitutes a "*settlement fail*". In our view, a settlement fail exists if agreed services have not been finally performed or not been finally performed in full (at the agreed point in time). The definition should include both payment and delivery.

5.3. Scope of a harmonised regime on settlement discipline

Q47. According to you, should future legislation promote measures to reduce settlement fails? Yes? No? No opinion? If yes, how could these measures look like? Who should be responsible for putting them in place? If no, please explain.

We believe it would make good sense to call on trading venues/market participants to take collective action to set out in their rules and regulations measures designed to prevent fails, the exact treatment of fails and possible penalties. Alternatively, the reduction of settlement fails could be accomplished by means of pricing, one element being the fee schedule of T2S.

5.4. Ex ante measures for settlement discipline

Q48. What do you think about promoting and harmonising these ex-ante measures via legislation?

We believe it would also make good sense to call on trading venues/market participants to take collective action to include ex-ante measures for settlement discipline in their trading practices/rules and regulations. Details could initially be left to the market/CCPs and OTC contract counterparties.

5.5. Ex post measures for settlement discipline

Q49. What do you think about promoting and harmonising these ex-post measures via legislation?

Trading venues/market participants should also be called on to take collective action to include ex-post measures for settlement discipline in their trading practices/rules and regulations. We would welcome harmonised enforcement rules aimed at creating transparency and comparability but would reject, by contrast, legislation on a harmonised penalty regime. Details could initially be left to the market/CCPs and OTC contract counterparties.

6. HARMONISATION OF SETTLEMENT PERIODS

Q50. According to you, is there a need for the harmonisation of settlement periods? Yes? No? No opinion? Please explain why.

Yes, we see a need to harmonise settlement periods for securities traded on trading venues defined by MiFID (cf. our replies to questions 53-55). We would recommend requiring a settlement period of T+2. This will improve the efficiency not only of securities settlement, but also of corporate actions in the European Union. Harmonised settlement periods are essential to the success of the standards set by the Corporate Actions Joint Working Group, which has based the determination of the record date on the settlement cycle.

Q51. In what markets do you see the most urgent need for harmonisation? Please explain giving concrete examples.

Harmonisation of settlement periods at T+2, as recommended by the HSCWG, should be limited to the settlement of securities traded on trading venues by MiFID (i.e. equities, bonds, warrants, certificates, ETFs). Parties to OTC transactions should remain free to agree their own terms and conditions. And standard periods in other markets, such as the highly efficient repo market, are already even shorter.

Q52. What should be the length of a harmonised period? Please explain your reasoning.

Since a comparatively short period is desirable from a risk angle, harmonisation should be based on the shortest existing periods in the EU market. For exchange-traded shares and bonds, this is T+2 – the period also recommended to the Commission in spring 2010 by the HSCWG. T+2 is also standard in the currency market. European securities markets will probably find T+1 settlement an overambitious target for the foreseeable future.

Q53. What types of trading venues should be covered by a harmonisation? Please explain your reasoning.

A harmonised settlement period of T+2 should apply to all trading venues defined by MiFID (regulated markets, MTFs, systemic internalisation and in future also organised trading venues).

Q54. What types of transactions should be covered by a harmonisation? Please explain your reasoning.

We would recommend that harmonisation should cover all secondary market transactions in cash markets except forward transactions in the above-mentioned types of security on trading venues defined by MiFID.

Q55. What would be an appropriate time span for markets to adapt to a change? Please explain.

We believe a period of 18 months after the directive enters into force would be appropriate.

7. SANCTIONS

Q56. According to you, how should the principles examined in the communication on sanctions apply in the CSD and securities settlement environment?

We basically welcome the Commission's objective of working towards a more coherent sanctions regime in the financial services sector. However, complex national legal factors in the area of sanctions, especially in legislation on crimes and misdemeanours, will frustrate attempts at sectoral pan-European harmonisation.

Contact:

The EACB trusts that its comments will be taken into account. For further information or questions on this paper, please contact:

Ms Marieke VAN BERKEL, Head of Consumer Affairs, Payments and Financial Markets
(vanberkel@eurocoopbanks.coop)
Mr Alessandro SCHWARZ, Senior Adviser Financial Markets
(a.schwarz@eurocoopbanks.coop)