

# Remarks on the proposed CSD Legislation and Securities Settlement Rules

Answers to the consultation document of the European Commission's  
Internal Market and Services DG of January 2011

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DACSI (the Dutch Advisory Committee Securities Industry) is the principal not-for-profit association in The Netherlands for firms active in the securities industry. The association represents the interests of its members as users/clients of infrastructure providers in the field of securities, e.g. exchanges, central counterparties, central securities depositories. With 12 members, DACSI represents the vast majority of the banks active in The Netherlands, and positions the Dutch view to the market infrastructure service providers and the regulatory authorities in The Netherlands and the European Union.

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Thank you for the opportunity to contribute to future legislation by making remarks on the EC consultation paper “Central Securities Depositories (CSDs) and Harmonisation of certain aspects of securities settlement in the European Union” (briefly “CSD consultation”)<sup>1</sup>. We hope that our contribution is helpful in the debate on the various issues addressed in the paper and are of course more than prepared to elaborate on particular items when helpful.

## General Remarks

We highly appreciate and fully recognise the importance of a level regulation of CSDs, as CSDs are a crucial part of the infrastructure for holding investments (as securities), in particular cross-border. As such, CSDs are an essential part of the European securities markets infrastructure.

We also concur with the necessity of stimulating the (further) harmonisation of settlement of securities transactions. This is crucial for the efficient processing of (cross border) transactions and holdings, and will gain strongly from a sound basis in legislation.

Before reacting to the specific questions in the consultation document, we want to state the following:

- The CSD plays a crucial role in the infrastructural chain. It is essential that a CSD eliminates various risks that otherwise may arise in trading and holding securities; not by underwriting others’ obligations – as a CCP does – , but by providing sound and safe structures and procedures.
- A CSD’s core functions are:
  - a. notary,
  - b. central safekeeping, and
  - c. settlement.
- To effectuate these functions, the CSD should run minimal risk. A certain level of operational risk is unavoidable, although to be managed very prudently; other risks have to be avoided to the maximum extent.
- A consequence is, that there is no room for any ancillary function beyond the core functions mentioned above. All ancillary functions mentioned in the consultation paper are not necessarily tied to the CSD’s core functions. They can be – and often are – performed by other entities, sometimes banks or other financial institutions.
- An institution performing the core CSD functions should be legislated as a CSD and hence not be allowed to perform activities adding to the risk of the institution. An institution with other (risky) activities, in particular that of a bank or a central bank, should not be licensed as a CSD.

## Answers to specific questions

### PART I : APPROPRIATE REGULATORY FRAMEWORK FOR CSDS

#### 1. Scope and definitions

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

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<sup>1</sup> DG Markt G2 D(201)8641

For us, a CSD is an institution performing the core CSD functions a. notary, b. central safekeeping and c. settlement, where it may occur that (part of) the notary function is performed by a third party, e.g. a registrar.

*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)?*

Each institution performing the 3 core functions, should be subject to the CSD legislation, without any exception or exemption .

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

DACSI fully agrees with the description and notes that the settlement functions include a pivotal role in corporate actions processing, as described in the Market Standards for Corporate Actions Processing: distributing the information or payments received from issuers (or their agents) towards the CSD's clients (either custodians or direct participants).

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

All three core functions a., b., and c., where it may occur that (part of) the notary function is performed by a third party, e.g. a registrar).

*Q5: Should the definition of securities settlement systems be reviewed?*

Yes. Article 2 of the SFD should be changed: such a system may only be operated by a licensed CSD.

*Q6: What is your opinion of the above description of ancillary services of a CSD?*

No ancillary services should be allowed at all, but only additional low risk functions that are necessary to perform the core services.

## **2. Authorisation and ongoing supervision**

For this and following sections, we reflect to selected questions only.

*Q7: According to you, could the abovementioned cases impact a future regime of authorisation and supervision? Are there other cases which could have an influence on a future regime of authorisation and supervision?*

A CSD could offer its core functions domestically and/or non-domestically.

*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, the requirements under the SFD are different from those under the future CSD legislation. Hence, any application should be assessed distinctly.

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

It is crucial that each CSD fully complies with the CSD regulation. This should not be compromised by deviating provisions in existing local regimes. Hence, there is no room for grandfathering. The period between the approval at

European level and the implementation in (local) legislation should suffice for the existing CSDs to adapt to the new rules, if necessary.

*Q12: According to you, does the above approach concerning capital requirements, suit the diversity of CSDs?*

We do not see much diversity amongst CSDs, as they all perform the same (core) functions.

*Q13: According to you, should the competent authorities have the above mentioned powers?*

In order to create a level playing field for the various CSDs, we envisage that ESMA specifies the technical requirements and is also involved in the ongoing supervision/oversight on CSDs.

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

Not relevant: banking type services should not be allowed for a CSD.

*Q15: Which of these three passporting options would you support?*

None of the 3: the passporting should only be valid for the core functions; once granted, the passport should be valid through the entire EU.

### **3. Access and interoperability**

*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?*

Trading venues by themselves do not need and should not be given access to CSDs.

For regulated venues where a CCP is active, the CCP generates the settlement instructions.

Where no CCP is active, trading counterparties c.q. their settlements agents should provide the settlement instructions and would need access to the CSD.

*Q23: According to you, should a CSD have a right to access transactions feeds?*

Not at all. Transaction data from trading venues should never result in direct settlement instructions for the CSD (see Q22).

*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?*

Future legislation should create a level playing field for incumbent CSDs and possibly new CSDs.

### **4. Prudential rules and other requirements for CSDs**

*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?*

Although not a natural place in the legislative “building”: we strongly support this requirement to hold in book entry form all securities with an ISIN code, with the prerequisite that a CSD can refuse instruments which would adversely impact the required low-risk profile.

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

DVP is one of the settlement methods that can be agreed by market participants. Other methods can be instructed as well, e.g. portfolio transfers, instructions related to borrowing/lending or a collateral basket.

DACSI opposes prescribing particular instruction/settlement methods in future legislation, but it is clear that they should be processed as part of the core settlement function of a CSD.

*Q39: According to you, should CSDs be subject to a principle of full responsibility and control on outsourced tasks?*

Sure! If not, the entire legislation would lose effectiveness.

Institutions performing the outsourced tasks should be subject to the same tight requirements as the CSD itself, thus avoiding an increase of the total (systemic) risk. As a consequence, CSD tasks should not be outsourced to a bank or a similar institution.

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

We wonder what the consequences are of a CSD having to buy in missing securities. This would create 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.

## **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. It is crucial that all transactions traded-cleared-settled on-by-with regulated entities in the chain are subject to fully harmonised processes. However, DACSI strongly prefers that the market drives this harmonisation process, and that future legislation will only provide a framework, leaving the technical requirements and details to the market.

*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.*

A few examples: differences in settlement cycles, non-standard messages, rebalancing between multiple settlement platforms.

*Q46: According to you, is a common definition of settlement fails in the EU needed?*

Yes.

A settlement instruction with the status “matched” fails if it cannot settle on the intended settlement date (time) due to a lack of securities (sell side) or a lack of money (buy side).

*Q47: According to you, should future legislation promote measures to reduce settlement fails?*

Yes, DACSI supports a harmonised regime in the future legislation for trades performed anonymously on a regulated market, cleared by a CCP and settled in a CSD. Under these circumstances, a buyer or seller – who does not know his economic counterparty - needs protection by a harmonised rule, but this regime should rather affect the CCP than the CSD.

These measures should have a sound basis in the (CSD) legislation; details are to be formulated functionally by ESMA. For non-anonymous trades – e.g. OTC transactions –, this protection is not needed; these counterparties can make arrangements for the consequences of non-settlement.

*Q54: What types of transactions should be covered by a harmonisation?*

Transactions on regulated markets only (see Q47).

For OTC-transactions, deviations from the standard settlement cycles must remain possible.