Securities settlement in the EU and central securities depositories (CSDs)

2012/0029(COD) - 14/02/2013 - Committee report tabled for plenary, 1st reading/single reading

The Committee on Economic and Monetary Affairs adopted the report by Kay SWINBURNE (ECR, UK) on the proposal for a regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC.

The report examines the current systems of settlements in order to determine if improvements might be made that would serve the interests of all investors. In the interests of both risk mitigation and ensuring a competitive environment for post trade services, the report looks closely at existing models for CSDs across the EU. It notes that one of the most immediate developments is the introduction of the **ECB's Target2Securities (T2S) system**, due to go live in 2015. While there has been a single CSD for each Member State, the introduction of T2S makes it possible to see how a more streamlined and integrated model might develop.

The committee recommends that the position of the European Parliament adopted in first reading, following the ordinary legislative procedure, should amend the Commission proposal as follows:

Purpose: it is clarified that the Regulation lays down uniform requirements for the settlement of financial instruments specified **the new Directive concerning the markets in financial services in the Union (MiFID)** and rules on the organisation and conduct of central securities depositories to promote **safe, transparent, efficient and smooth settlement**.

In view of the global nature of financial markets, and the systemic importance of the CSDs, the provisions of the Regulation should follow the **global principles** for **financial market infrastructures** devised by the Committee on Payments and Settlement Systems (CPSS) of the Bank of International Settlements (BIS) and the International Organisation of Securities Commissions (IOSCO) and the recommendations of the European System of Central Banks (ESCB) and the Committee of European Securities Regulators (CESR) for **securities settlement systems and recommendations for central counterparties (CCPs)** in the Union.

The Regulation should **not make changes to existing CSD models or services** unless they cannot meet the objectives of the Regulation or they pose undue risks.

Settlement Cycles and Settlement discipline: investment firms authorised pursuant to the new MiFID Directive and professional clients within the meaning of that Directive shall agree and take such measures as are necessary to **limit the number of settlement fails**. Such measures shall include, in the case of the client, where applicable, the prompt communication of an allocation by the client of the transaction to the investment firm no later than the end of the day on which the trade is executed and the issuance of a corresponding confirmation by the investment firm. The means by which such measures shall be performed shall be agreed between the parties and shall include use of a **standardised messaging protocol**.

For each securities settlement system it operates, a CSD shall establish **monitoring tools** that allow participants in that system to identify transactions in financial instruments that contain an increased risk of failure. The CSD and those participants shall **inform each other about such transactions as early as possible** and they shall have in place procedures to ensure they or their clients are able to settle such transactions on the intended settlement date.

All settlement fails should be reported to the competent authority and disclosed publicly in an aggregated format on a regular basis.

In order to reduce the problems caused by settlement fails it is provided that **sanctions** be imposed upon offending market participants and that receiving parties are able to initiate a buy-in procedure four days after the intended settlement date should their counterparty have failed to deliver the securities.

SME Growth Markets: Members consider that all EU markets legislation should be properly tailored for SME Growth Markets, so as to encourage more SMEs into the capital markets, particularly so as to reduce companies' reliance upon bank lending.

In the case of SME growth markets, the amendments aim to allow those venues the **flexibility** not to apply sanctions for settlement fails or the buy-in procedure until up to 15 days after the trade has taken place so as to allow the activity of market makers in those less liquid markets.

Supervision: responsibility for authorising and supervising CSDs should remain primarily with the Member States. However, in order to facilitate the efficient development and then coordinate the supervision of a single European post-trade infrastructure, the European Securities and Markets Authority (ESMA) should be involved in coordinating the activities of competent authorities. That cooperation should take place under the aegis of the ESMA peer review mechanism, ensuring that all interested competent authorities receive all relevant information concerning the activities of CSDs within the Union.

Internalisation: settlement internalisers, although not defined as CSDs in the Regulation, are required **to report their settlement activities** to their competent authority. Furthermore, ESMA will monitor internalised settlement, particularly after the introduction of Target2Securities. If systemic risk prevalence increases, ESMA will be able to issue guidelines requiring more detailed reporting.

Banking Services: in order for CSDs to be as resilient as possible, and maintain a level playing field across the entire EU, Members feel that when a CSD wants to provide banking services to perform its primary function, it will be required to **establish a separate legal entity** constituted under the relevant banking legislation (CRD IV) to provide these services.

CSD links: a new recital states that the Regulation should have the objective of increasing competition, reducing cross-border barriers and improving Union-wide reachability among participants, custodians and end investors in order to serve the whole Union and the internal market. Important features supporting those objectives are **freedom to provide cross-border services and efficient infrastructural links among CSDs and towards other entities.**

Third-country CSDs should be able to set up standard links with CSDs established in the Union in the absence of such recognition provided that the relevant competent authority does not object.

Segregation: CSDs should, when providing their services, ensure the requirement to offer, upon request, both **omnibus accounts**, where appropriate, in order to increase efficiencies and single beneficiary accounts so clients can choose the level of segregation they believe is appropriate to their needs. Those services should be provided on a reasonable commercial basis.

Transparency: supervisors must have knowledge of the level, at least in aggregate terms, of institutions' repurchase agreements, securities lending and all forms of encumbrance or claw back arrangements in order for supervisors to have a full picture and understanding these operations which are not transparent and may give rise to uncertainties in settlement and ownership. CSDs should, therefore, store all data on such transactions which they process and where applicable provide services for, and allow access to such information, inter alia, by ESMA, EBA, relevant competent authorities, the ESRB, relevant central banks and the ESCB.

Conflict of laws: lastly, a new recital states that when applying the Regulation to solve the issues raised by any conflict of law, it is important that the Regulation does not seek to determine the law applicable to the treatment in insolvency proceedings of financial instruments recorded on an account maintained by a CSD or the effect with respect to such financial instruments of death, dissolution, inheritance or succession, divorce, mental health, incapacity or criminal proceedings.