EUROPEAN COMMISSION

Directorate-General for Financial Stability, Financial Services and Capital Markets Union

Summary report of the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories

8 December 2020 – 2 February 2021

This document provides a factual overview of the contributions to the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories that took place from 8 December 2020 to 2 February 2021. The content of this document should not be regarded as an official statement of the position of the European Commission on the subject matters covered. It does not prejudge any feedback received in the context of other consultation activities.

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1. INTRODUCTION

Central Securities Depositories (CSDs) are financial institutions of systemic importance. They operate the infrastructure (so-called securities settlement systems) that enables securities settlement, i.e. the completion of a securities transaction with the aim of discharging the obligations of the parties to that transaction through the transfer of cash or securities, or both. CSDs also play a crucial role in the primary market, by centralising the initial recording of newly issued securities (the so-called "notary service"). They also ensure the maintenance of securities accounts that record how many securities have been issued by whom, and each change in the holding of those securities (the so-called "central maintenance service").

The framework for CSD operations in the EU is set by Regulation (EU) No 909/2014 of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDR)[1]. CSDR was adopted following the financial crisis of 2008 to ensure that securities settlement is safe and efficient. It entered into force on 17 September 2014 and provides a set of common requirements for CSDs across the EU by introducing:

- Shorter settlement periods;
- Cash penalties and other deterrents for settlement fails;
- Strict organisational, conduct of business and prudential requirements for CSDs;
- A passport system allowing authorised CSDs to provide their services across the EU;
- Increased prudential and supervisory requirements for CSDs and other institutions providing banking services that support securities settlement;
- Increased cooperation requirements for authorities across Member States with respect to CSDs providing their services in relation to financial instruments constituted under the law of a Member State other than of their authorisation and to CSDs establishing a branch in another Member State.

Article 75 of CSDR stipulates that the Commission should review and prepare a general report on the implementation of the Regulation. Furthermore, under Article 81(2c) of Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority)[2], the Commission is required, after consulting all relevant authorities and stakeholders, to conduct a comprehensive assessment of the potential supervision of third-country CSDs by ESMA. This assessment should explore certain aspects, i.e. including recognition based on systemic importance, ongoing compliance, fines and periodic penalty payments. Recently, the

[1] Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories

[2] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

2020 Capital Markets Union Action Plan[3] and the European Parliament's resolution[4] on further development of the Capital Markets Union also called on the Commission to review specific aspects of the CSDR, i.e. cross-border provision of settlement services in the EU and the settlement discipline regime respectively.

To support this review, a targeted consultation[5] was conducted between 8 December 2020 and 2 February 2021.The Commission sought feedback in areas where targeted action may be necessary to ensure the fulfilment of the objectives of the CSDR in a more proportionate, efficient and effective manner, notably:

- CSD authorisation & review and evaluation processes;
- Cross-border provision of services in the EU;
- Internalised settlement;
- CSDR and technological innovation;
- Authorisation to provide banking-type ancillary services;
- Scope of requirements applying to the settlement of financial instruments;
- Settlement discipline.

The Commission received 91 responses to the targeted consultation and would like to thank all respondents for their contributions.

This feedback statement provides a factual overview of the contributions received. Any positions expressed in this feedback statement reflect the contributions received and not the position of the European Commission and its services.

2. OVERVIEW OF RESPONDENTS AND RESPONSES

2.1. Who responded?

As seen in Tables 1 and 2, the majority of responses to the targeted consultation came from firms and industry associations, i.e. 43 companies/business organisations and 33 business associations. In addition, responses were received from 10 public authorities, one NGO and four entities categorised as "Other"[6]. Among the companies and business associations responding[7], most indicated the following as their main field of activity: banking (30 respondents), operation of financial market infrastructure[8] (23 respondents) or investment management (13 respondents). No private individuals responded to this targeted consultation.

[3] Communication from the Commission – A Capital Markets Union for people and businesses – New Action Plan, COM (2020) 590. See Action 13.

[4] European Parliament resolution of 8 October 2020 on further development of the Capital Markets Union (CMU), (2020/2036,(INI)). See Paragraph 21.

[5] The targeted consultation questionnaire is available at the dedicated Commission website: https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en

[6] This included a law firm, bank, start-up CSD and an investor association.

[7] When several activity fields were indicated, the first pick was used for categorisation

[8] This includes both CSDs, Central Counterparties (CCPs) and stock markets.

Table 1: Types of entity replying

Replying as	
Company/business organisation	43
Public authority	10
Business association	33
Non-governmental organisation (NGO)	1
Other	4
Total respondents	**91**

Table 2: Main field of activity of respondents

Main field of activity of respondents	
Accounting	2
Banking	30
Investment management	13
Financial market infrastructure operation	23
Other	18
Not applicable	5
Total respondents	**91**

As seen in Table 3, responses were received from 18 Member States, with the largest number coming from Germany (12), Belgium (8), France (8) and the Netherlands (7). In addition, a number of responses came from outside the European Union, mainly the United Kingdom (17) and the United States (8).

Table 3: Country of origin of respondents

Country of origin of respondents	
Austria	4
Belgium	8

Country	Respondents
Croatia	1
Czechia	1
Denmark	2
Finland	2
France	8
Germany	12
Italy	4
Ireland	1
Latvia	1
Luxembourg	2
Malta	1
Netherlands	7
Poland	2
Romania	1
Spain	3
Sweden	3
Switzerland	3
United Kingdom	17
United States	8
Total respondents	**91**

As seen in Table 4, responses were received from all organization sizes, from micro size (12) and small size (18) to medium (21) and large size (40).

Table 4: Organisation size of respondents

Organisation size	
Micro (1 to 9 employees)	12
Small (10 to 49 employees)	18
Medium (50 to 249 employees)	21
Large (250 or more)	40
Total. respondents	**91**

Although 91 contributions were received in total, the number of provided responses varied between the different sections of the consultation. More specifically:

- **CSD authorisation & review and evaluation processes:** 25 respondents provided input to at least one question contained in this section. The respondents represented either public authorities or CSDs.
- **Cross-border provision of services in the EU:** 36 stakeholders responded, including public authorities, CSDs and their participants and asset managers.
- **Internalised settlement:** 41 stakeholders responded, including companies, business associations and public authorities.
- **CSDR and technological innovation:** 39 respondents provided input to at least one question contained in this section. The respondents represented companies/ business organisations, public authorities and business associations.
- **Authorisation to provide banking-type ancillary services:** 34 respondents provided input to at least one question contained in this section. The respondents represented mainly public authorities, companies/ business organisations, business associations.
- **Scope of requirements applying to the settlement of financial instruments:** 58 respondents provided input to at least one question contained in this section. These include public authorities, CSDs, their participants, clients of the participants and associations.
- **Settlement discipline:** 90 respondents provided input to this section.
- **Framework for third-country CSDs:** 24 stakeholders, including national competent authorities, industry associations, CSDs responded to the section of the consultation.

In addition, 37 respondents provided input when asked about other areas to be considered in the CSDR review.

2.2. Key messages

The key messages from the consultation were the following:

- According to a vast majority of respondents,[9] the rules on the **cross-border provision of services in the EU** need to be revised, in particular to clarify and simplify the passporting rules as well as to enhance the cooperation between national competent authorities (NCAs).

- CSDs argued that the rules on the **authorisation to provide banking-type ancillary services** hinders settlement in foreign currencies and restricts access to liquidity for CSDs not authorised to provide banking-type ancillary services.

- The **settlement discipline regime** was the topic for which the Commission received the most contributions. All stakeholders agreed that clarity on the way forward is needed as soon as possible.

- The **framework for third-country CSDs** raised questions amongst all categories of stakeholders, in particular on the need to have more information on third-country CSDs providing services in relation to financial instruments constituted under the law of a Member State.

- Respondents supported the simplification of certain requirements regarding **CSDs' authorisation, annual review and evaluation,** as well as review of the **grandfathering clauses**.

- A majority of respondents were of the view that **immediate action is not required on two topics**: (a) **technological innovation,** because they consider that any changes to CSDR to realise the full potential of fintech should be postponed until the Pilot Regime Regulation[10] is agreed upon by the co-legislators and implemented; and (b) **internalised settlement,** as the obligation has been in force only for a limited period of time.

3. SUMMARY OF RESPONSES

3.1. Competition amongst CSDs in the EU

At the time of adoption of CSDR, settlement markets in the Union were fragmented. This was identified as a source of risk and additional costs for cross-border settlement. Given the systemic relevance of CSDs, the promotion of competition between CSDs was one of CSDR's objectives, with the view to creating a single market for securities settlement, allowing any investor in the Union to invest in all Union securities with the same ease as

[9] Please note that references to the "majority"/"minority" etc. of the respondents in this feedback statement refer to the respondents that replied to a particular section/question of the consultation.

[10] Proposal for a Regulation of the European Parliament and the Council on a pilot regime for market infrastructures based on distributed ledger technology, COM(2020) 594.

in, and using the same processes as for, domestic securities. This was considered essential to the proper functioning of the internal market.

Most stakeholders, all categories included, did not express an opinion, as to whether CSDR has actually increased competition amongst CSDs.

A group of stakeholders representing central banks, CSDs and their participants, as well as a CSD and a bank underlined though that **data on competition in the CSD market and the level of cross-CSD settlement does not provide evidence of a significant increase in competition or cross-border services or cross-CSD settlement**. According to those stakeholders, reasons for the lack of evidence for increased competition between CSDs and the absence of significant cross-CSD settlement include: (a) diverging national practices in corporate actions processing and diverging national corporate laws or corporate governance rules; (b) diverging practices in withholding tax refund and relief-at-source procedures; (c) diverging market practices in collateral management; (d) lack of harmonisation in issuance procedures. Several other stakeholders also made similar comments, noting that such national divergences also hinder mergers of CSDs.

A few respondents, including CSDs, a public authority and a market maker **had a positive view on CSDR's impact on competition**. In particular, it was noted that the harmonisation brought about by CSDR (which according to a bank enhanced, amongst other things, the transparency of CSD fees and introduced high standards for CSDs' operations) **contributed to competition amongst CSDs in the European Union**. Some stakeholders noted that CSDR's impact on competition should not be analysed in isolation as many other factors, such as the **launch of T2S** and the related harmonisation efforts, had impacted the CSD market in recent years.

3.2. CSDs' authorisation, review and evaluation

CSDs are subject to authorisation and supervision by the competent authorities of their home Member Sate which examine how CSDs operate on a daily basis, carry out regular reviews and take appropriate action when necessary.

Under Articles 16 and 54 of CSDR, CSDs should obtain an authorisation to provide core CSD services as well as non-banking and banking-type ancillary services. Article 69(4) however allows CSDs authorised under national law prior to the adoption of CSDR to continue operating under such national law until they have been authorised under the new CSDR rules (the so-called "grandfathering clause").

Once a CSD has been authorised, CSDR requires NCAs to review its compliance with CSDR and to evaluate the risks to which the CSD is or might be exposed, as well as the risks it might create. This must be carried out at least annually, with the NCA's determining .the specific depth and frequency of the review and evaluation taking into consideration the size, nature and systemic importance of the CSD under supervision.

The Commission sought feedback from the respondents on the effectiveness and efficiency of the above-mentioned requirements.

Less than one third of the respondents to the targeted consultation mainly public authorities or CSDs,provided feedback on the authorisation, review and evaluation section.

3.2.1. CSD authorisation process under CSDR and the grandfathering clause

Regarding the need for refinement of **the authorisation process** set out in CSDR, views were split amongst participants. A quarter of the respondents considered that **some clarifications should be provided**. Clarifying the meaning of the term "**substantive change"** in Article 16(4) and **improving convergence in the process of authorisation** were their top priorities.

Only a few respondents saw a need to **amend the current requirements**, amongst others, in relation to: (i) technological innovation, such as DLT (see section 3.5 below); (ii) the interaction between the authorisation for core and non-banking type ancillary services, especially as regards designated credit institutions (see section 3.6 below); (iii) the amount of detailed information that an applicant CSD should provide to its competent authority, which was considered to be too burdensome by some of the respondents.

More than a third of stakeholders considered that there is **no case for amending the relevant rules**. Among these respondents, half of them **(**mostly public authorities) argued that most of the CSDs in the Union have already been authorised under CSDR, therefore, changing the authorisation requirements would unduly advantage CSDs not yet authorised. The other half of respondents who did not favour amending the authorisation requirements **(**mostly CSDs) considered that the complexity of the CSDs' business justifies the length and complexity of the procedure.

Regarding the **grandfathering clause** contained in **Article 69(4)**, a third of respondents considered that it should not be removed immediately as this would cause significant disruption. In particular, several respondents mentioned the delayed application of CSDR in EEA-countries. Other respondents considered that the grandfathering clause be revoked as it represents a risk to the level playing field among CSDs in the EU.

3.2.2. The annual review and evaluation process

Most respondents considered that **the frequency of the annual review process should be amended**, with a strong majority in favour of a review process every three years. Other respondents in favour of amending the framework would prefer to leave it to NCAs to decide the frequency of this exercise. The arguments in favour and against modifying the frequency of these reviews vary. A number of respondents, even among those who have not expressed a view on whether the frequency should be amended, indicate that the review and authorisation process should be more proportionate.

Concerning the information and statistical data to be provided by CSDs to NCAs, the views were split: more than half the respondents tended to consider that not all of it is relevant while a slightly higher proportion considered that it is disproportionate.

3.2.3. Enhancing convergence in the authorisation, review and evaluation processes

Views were split on the potential need for more cooperation between authorities in the review and evaluation process. More than half of the respondents considered that there is clear need for **improving cooperation among authorities and convergence in the review and evaluation process**. One respondent pointed out that the report of the CMU High-Level Forum recommends strengthening supervisory convergence among NCAs as **the different application of CSDR directly impacts the cross-border provision of services**. Some respondents further pointed out the need to **strengthen cooperation among NCAs for larger CSD groups that operate in several Member States**.

On **the role of ESMA**, generally speaking, respondents recognised its importance in promoting convergence, although most did not support granting direct supervisory powers to ESMA. Respondents seemed to prefer targeted amendments to existing regulatory requirements to enhance ESMA's role, including the creation of colleges with the direct participation of ESMA, or a better use of tools currently available. A few respondents asked the Commission to follow Recommendation 17 of the CMU High-Level Forum report which invites to strengthen ESMA's governance, powers and toolkit.

3.3. Cross-border provision of services within the EU

A core objective of CSDR is the creation of a single market for CSDs by granting CSDs authorised in one Member State with a "passport" to provide their services in another Member State. When CSDs wish to provide notary and central maintenance services in relation to financial instruments constituted under the law of another EU Member State or to set up a branch in another Member State a specific procedure needs to be followed, involving host NCAs ('passporting authorisation process'). 36 stakeholders responded to this section of the targeted consultation including public authorities, CSDs and their participants as well as asset managers.

3.3.1. CSDR passport regime

The majority of stakeholders, including public authorities, CSDs and industry associations, considered that **various aspects of CSDR merit clarification** in order **to improve the provision of notary, central maintenance and settlement services across borders within the Union**. Similarly, all CSDs and their association responding to this question as well as some public authorities, noted difficulties in the process of obtaining the CSDR passport in one or several Member States, which derive not only from CSDR but also from the delegated acts and Level 3 measures. One CSD noted that it stopped providing services with respect to foreign securities in order to avoid the passporting process.

A CSD also noted that any amendment of the provisions related to the cross-border provision of services should not mean that CSDs that have already obtained the passport to provide their services in other Member States under Article 23 have to reapply, in order to ensure continuity in the provision of services.

3.3.1.1. The design of the CSDR passport regime:

An industry association representing CSDs noted that, contrary to the approach followed in other areas of EU financial services legislation where the provision of cross-border services is defined by the business choice of the relevant entities to provide services in another jurisdiction, **the defining factor in CSDR is the law under which the securities are constituted**. The consequence is that CSDs need to ask for multiple passports which deters CSDs from expanding their cross-border offering.

Certain CSDs stated that Article 23 of CSDR should not be interpreted as **requiring CSDs to endorse and comply** with the requirements set by the national law under which the securities are constituted. Certain CSDs and their association claim that there is real cross-border provision of services only **where a settlement system under the laws of another jurisdiction is established and either notary services or central maintenance service**s are provided. CSDs through their association noted that CSDs **can no longer allow issuers to issue securities according to the law of an EU Member State other than the one where securities are centrally held**, unless they have received authorisation from that Member State. CSDs also noted that some NCAs wish to request the passporting under CRR[11] and CRD IV[12] for the CSD ancillary-type banking services, even though this is not required under CSDR.

Exchange of information and formal supervisory cooperation arrangements are detailed in delegated acts whenever the cross-border activity is deemed significant in the host Member State. CSDs submitted that there is **disproportionate direct involvement in the supervision on the CSD from the host NCA** as, in the cases contemplated by the delegated acts, the service is not actually offered or the activity is not actually performed abroad.

3.3.1.2. Interpretation of the concept “securities constituted under the law of a Member State” in Article 23(2) and Article 49(1)

Certain stakeholders noted that this concept should be understood as referring only to the “***governing law***”, i.e. the terminology used by issuers and their agents in the various instruments (prospectus, term notes, articles) supporting issuance. According to some of these stakeholders, the application of the ‘***issuer law***’ on top of the governing law to determine the scope of the assessment **creates uncertainty and fails to take into account the market practice**.

[11] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms
[12] Capital Requirements Directive IV comprises Directive 2013/36/EU and Regulation (EU) N° 575/2013 on banking prudential requirements.

A public authority noted that the diversity of national laws that need to be considered in each case makes each passporting request very specific. Furthermore, CSDs propose different measures to comply with host Member States' national laws that varies from putting the burden on the issuer as a condition for admission of securities, to the detailed explanations by the CSD of the various setup of issuances processes.

A public authority also noted that it is not clear in CSDR which national law Article 49(1) of CSDR refers to, **in particular, when the financial instrument issued is a bond.** It argued that ESMA's answer in CSDR Q&A 9 is not efficient since it could imply that for a **single issuance** in respect of which a CSD provides core services, the **CSD might be required to request two separate passports** (i.e. on the basis of both the national law of the issuer and a different law chosen to govern the issuance).

Another public authority highlighted that the **home NCA is not in a position to assess compliance with the securities laws of the host Member States**.

A public authority noted that when an issuer established in a Member State opts to use the services of a CSD established in another Member State and the securities are constituted in a Member State law different to the one of its establishment, **the national supervisor of the Member State where the issuer is established is not able to get any information on the activities that the CSD performs**. Indeed, this national supervisor is not considered a "host Member State authority" for the CSD according to CSDR. This public authority considered this is an issue that needs to be addressed.

A CSD advocated in favour of developing harmonised criteria for Member States to identify which areas of law are actually relevant for the purpose of ensuring that CSDs are able to process securities in their systems according to the applicable law. Other CSDs and their association submitted that the list of key relevant provisions in the third subparagraph of Article 49(1) should be made more transparent and simpler, by specifying exactly which provisions under local law a foreign CSD must comply with. A CSD also referred to the costs associated with the legal due diligence on the Article 49(1) list of key relevant provisions.

3.3.1.3. The scope of financial instruments subject to the procedure of Article 23

CSDs argued that the **CSDR passporting regime should be limited to shares only** rather than all "transferable securities". This, they said, would remove the barrier for the issuance of debt securities which did not exist prior to CSDR (e.g. a public authority noted that registering Eurobonds in an ICSD is much more complex now) and would greatly **simplify the process of determination of the relevant law for the purposes of Article 23** since the law that usually governs shares is the law of the issuer. It would therefore ensure that only one host NCA would be involved in the passporting authorisation process.

3.3.1.4. The process of handling passport applications

Generally speaking, CSDs raised concerns about the **length and the burdensome nature of the process** to obtain a passport. The need for information from NCAs should not be a condition to the passporting, nor should the information exchange between NCAs represent such an important administrative burden. These respondents suggested improving transparency and standardising the process of granting passports under CSDR.

A public authority considered that there is an **imbalance between the time allotted by CSDR for the host Member State to review the application and the complexity of the assessment**.

CSDs have also observed a **divergence in the way different NCAs handle applications** under Article 23, e.g. as concerns information and data to support an application or the level of detail requested with respect to the measures CSDs take to allow their users to comply with the laws of the host Member State. According to CSDs, NCAs seem to request more information and data than required under EU rules.

Certain stakeholders raised concerns about the lack of clarity on the **role of the host NCA and its involvement in the process,** which has led to diverging interpretations among Member States. Issues mentioned include the possibility for the host NCA to request additional information before being able to make a decision; the criteria on the basis of which the passporting request can be rejected; whether in that case the passporting process should be put on hold until the issue is resolved. A public authority also observed that CSDR provides only for the possibility to grant or to reject the request, whereas it may be incomplete or based on a different interpretation of CSDR.

Few stakeholders, notably a bank and a public authority, advocated in favour of **replacing the passporting authorisation process with a notification.** One CSD argued that the **passport should be automatic** without any further authorisation or notification process, a view with which one **public authority explicitly disagreed**.

3.3.1.5. Restrictive national law favouring domestic CSDs

CSDs and a group of stakeholders representing central banks, CSDs, their participants and the banking sector raised concerns about national requirements favouring local CSDs, thereby leading to an unlevel playing field. Such requirements include: different tax treatment of securities issued via national CSDs and EEA CSDs; restrictions to the holding of the securities issued via a foreign CSD; additional reporting for non-domestic CSDs (not required under the CSDR); the requirement to open a CSD branch as opposed to a passport regime; and national laws restricting the choice of account types or level of segregation.

3.3.1.6. Measures preventing truly free access and choice by issuers

A group of stakeholders representing central banks, CSDs and their participants noted that the right of issuers to freely select the CSD in which they would like to issue is subject to the level of consistency between the national legal requirements of the issuer's country of establishment and the issuer CSD's regime as set out in Article 89 of the Commission Delegated Regulation (EU) 2017/392 on "Criteria justifying refusal of access". To address this, respondents suggested that CSDR could actively require Member States to remove the provisions restricting or preventing issuance in foreign CSDs from their national legal regimes.

3.3.2. CSDs' cross-border activity in the EU and the impact of CSDR passport procedure

A few CSDs provided information as to the **number of Member States in which they have obtained a passport** (one CSD in two Member States; one CSD in seven Member States and one EEA country; one CSD currently operates under the grandfathering regime and has sought passporting in 27 EU Member States plus two EEA countries; two CSDs in 25 Member States; one in 23 Member States; one in 24 Member States; two in four Member States; one CSD said that due to the difficulties encountered by regulators in applying the passporting regime, it is not possible to answer in how many Member States they currently service issuers by means of the CSDR passport).

The majority of CSDs considered that the passporting process has not prevented CSDs from offering issuer CSD services for securities constituted under the laws of another Member State as such, but **has slowed down their ambitions**. Certain CSDs noted that they had to **withdraw some passport requests due to local constraints that are disputable**, e.g. compliance with the direct individual segregation model applicable under national law. A few CSDs also noted that investors and issuers will be attracted to issue in non-EU 27 jurisdictions to avoid Member States' "cumbersome and protectionist" requirements.

A CSD further noted that the provision of **notary services for securities constituted under the law of a non-EU Member State could be easier and more efficient** to carry out than for those constituted under the law of an EU Member State. It was also noted that as the process and the authorisation itself is limited to the type of securities a CSD is offering at the moment of authorisation, it is very difficult to expand services to issuers who want to issue other types of securities.

3.3.3. Cooperation among NCAs in the cross-border provision of services

The majority of respondents, including mainly public authorities and banks, considered that the **cooperation amongst NCAs would be improved if colleges were established** and they were always involved in the Article 23 process. Few public authorities though were in favour of **mandatory colleges** for the monitoring of the activities of the CSDs. One specified that mandatory supervisory colleges in the meaning of Regulation (EU) No

1095/2010 should be established when: (a) a CSD has acquired substantial importance in several Member States or (b) two or more EU CSDs are owned by a single parent company. One public authority was in favour of **voluntary colleges** noting that, even though the college has no decision-making power, it could serve as a forum for discussion and information exchange, and provide the possibility to use the expertise of other authorities, e.g. in large assessment projects where tasks could be divided upon the authorities' agreement.

Other stakeholders, mainly banks, noted that **colleges of supervisors would provide consistency, avoid regulatory arbitrage and promote competition**. Colleges could also be a mechanism to allay concerns related to NCAs' access to information and intervention powers. Certain stakeholders, mainly banks, even submitted that in order to ensure a fair and competitive level playing field, **single supervision was a prerequisite for more integrated EU capital markets**.

On the contrary, **certain CSDs and public authorities opposed the establishment of supervisory colleges**. Some of them noted that the problem with Article 23 passporting process lies in the interpretation of rules by NCAs and not in a lack of cooperation amongst them. Certain CSDs argued that even if colleges were established, they would not be able to counter diverging national laws, the requirement to open a CSD branch to issue equities or tax benefits for securities issued via the national CSD. A public authority noted that CSDs have a different risk profile from Central Counterparties (CCPs) and do not require such a heightened level of cooperation and engagement. Certain public authorities also stated that CSDR already provides for the cooperation of competent authorities and that the problems observed could be resolved by clarifying the tasks and timing of action for home and host authorities. For example, when the host NCA does not react within the three-month provided in CSDR, in some cases the home NCA may be reluctant to allow the CSD to passport to the host Member State.

3.3.4. The role of ESMA in enhancing supervisory convergence

Many stakeholders were in favour of **enhancing ESMA's role to ensure convergence in the supervision of CSDs** that provide their services on a cross-border basis within the EU. Suggestions made by individual stakeholders included:

- **Further empowerments for RTS and / or guidelines** (e.g. to further specify the roles and duties in the cooperation between NCAs and relevant authorities under Article 23 of CSDR), and an **enhanced ESMA role in colleges**.
- **Sanctions** by ESMA for protectionist practices or interpretations by NCAs or the establishment of barriers created at Member State level.
- ESMA should play a **central role in ensuring uniformity in the supervision of CSDs across Europe**, even in respect of CSDs that do not provide issuer services on a cross-border basis.
- ESMA should play an important role in achieving **greater harmonisation and uniformity** with respect to **national corporate law requirements** relating to the

issuance processes, the attribution of corporate action entitlement, and corporate action processing. According to this view, such harmonisation and uniformity is an important pre-condition for the effective ability of CSDs to provide issuer services on a cross-border basis. However, a public authority noted **that CSDR should not amend national corporate law that governs issuance**, and **cannot empower CSDs from other Member States to not apply it**.

- ESMA could **support the market standards work** undertaken in the context of the ECB's Debt Issuance Market Contact Group, and the ECB's AMI-SeCo Group and promote **initiatives aimed at developing the existing interaction between market operators, market infrastructures and NCAs** in order to, inter alia, assess the barriers in the provision of cross-border CSD services and analyse possible operational remedies.
- Some stakeholders noted that **EBA** also has a role to play in enhancing supervisory convergence for CSDs and potentially also the **ECB**.

However, it is worth noting that a few public authorities were against granting ESMA further powers, in particular supervisory powers.

3.4. Internalised settlement

According to Article 9 of CSDR, a settlement "internaliser" (i.e. any institution which executes transfer orders on behalf of clients or on its own account other than through a securities settlement system) must report to the competent authority of its place of establishment, on a quarterly basis, the aggregated volume and value of all securities transactions that it settles outside a securities settlement system (SSS).

In total 41 respondents provided replies to questions related to internalised settlement, mostly companies and business associations primarily from the banking sector and market infrastructure operations. In addition, several public authorities responded.

3.4.1. Internalised settlement reporting

The **majority of respondents**, including public authorities, companies or business associations active in banking and financial market operations, **agreed that the collected data is effective, efficient, coherent, relevant and provides EU added value** with the main advantage of the reporting obligation being **increased market transparency**.

The majority of respondents agreed that the obligation of internalised settlement reporting has been in force only for a limited time, hence it is **too early to determine whether amendments are necessary**. Furthermore, most respondents highlighted that setting up and running the reporting systems has required considerable investments and any changes should be carefully considered as they may lead to additional implementation costs with limited value. The systems are now running and potential implementation problems have been solved by guidance issued by ESMA, in particular with respect to the granularity of data. Overall, the respondents seemed to **prefer to keep the current reporting obligation unchanged**.

Only, a minority of respondents from the banking sector questioned the relevance and EU added value of the collected data, due to its granularity. However, even they suggested that more time should be given to see the full effects of the data collection before reviewing the obligation.

Several respondents raised comments regarding the coherence and consistency of the reported data, in particular with respect to the practice of summing up the 'quantity' (nominal value) of the securities, as many times as the number of days in which a transaction remains in fail. According to them, such reporting may be misleading by exaggerating settlement fails on internalised instructions.

Several respondents confirmed the findings contained in recent the ESMA report[13] of **high level of internalised settlement activity in several jurisdictions accompanied by a high degree of concentration** and called for continuing monitoring of this activity and the associated risks. Furthermore, some respondents, mainly CSDs and stock markets, even called for **expanding the settlement discipline regime to internalised settlement activity** to avoid circumvention of the regime. These respondents claimed that a competing business model may be emerging where companies settle trades outside the CSD framework. As a counter-argument others claimed that a high level of internalised settlement stems from tri-party collateral managers, reflects a high use of omnibus accounts (Article 38 CSDR) and actually achieves the CSDR objective of reducing settlement fails while reducing risk.

3.4.2. Internalised settlement reporting - Thresholds

Over half of the respondents were **against the introduction of any thresholds** for internalised settlement reporting while only a small minority wanted to introduce minimum thresholds above which reporting would become mandatory, to be based either on volume, value or some other criterion.

Respondents against reporting thresholds recognised the objective of reducing administrative burden that such a threshold may bring, but thought any savings would be limited. **Cost impacts for the reporting requirements were primarily up-front investment** needed to set up the reporting capabilities prior to the entry into force of the obligation in 2019. Furthermore, thresholds would add operational complexity as they would necessitate constant monitoring whether the firm is above or below the reporting threshold. Some respondents stated that even with the introduction of thresholds, they would continue reporting the entirety of their internal settlement activity as the monitoring and operational costs of having the reporting system always in place are just too great. Furthermore, they were opposed to the introduction of thresholds at national level which could create disparities within the EU and weaken harmonisation of the rules. Some public authorities also highlighted the high monitoring costs to oversee whether individual firms are above/below the threshold.

[13] "Report to the European Commission: CSDR Internalised Settlement", European Securities and Markets Authority, ESMA70-156-3729, 05 November 2020

The need for proportionality was the main argument of the minority of respondents that asked for the introduction of thresholds. There was however no clarity about which threshold would be the easiest to manage or what their level should be.

3.5. CSDR and technological innovation

Recent innovations in the field of finance have the potential to revolutionise the financial system, including post-trade services. In particular, the distributed ledger technology (DLT) and the tokenisation of securities may transform clearing and settlement by simplifying processes, reducing costs and increasing security. On September 2020, the Commission published a proposal[14] for a pilot regime for market infrastructures based on DLT.

Overall, 39 entities responded to at least one question on CSDR and technological innovation. Respondents included 21 companies/business organisations, seven public authorities, 10 business associations and one respondent categorised as “Others”. Among the 21 companies/business organisations, 11 defined financial market infrastructure operations as their main field of activity, including six CSDs and five trading venues.

Although there is a clear separation of views between users and operators of financial market infrastructures, with the former being more concerned about the implications of the technology for the post-trading space, the majority of respondents share certain positions:

- **CSDR must remain technology neutral**. Furthermore, emerging providers of post-trade services must submit to the same rules as incumbents, i.e. several replies refer to the “same service, same risk, same rules” principle. Concerns about specific aspects of the use of CSDR in a DLT context are displayed by users of financial markets infrastructure, but they requested clarifications rather than dismiss the relevance of CSDR for DLT purposes. Overall respondents seem less concerned about CSDR introducing barriers to the use of DLT, but rather highlight the importance of delegated acts and Level 3 rules to maintain technology neutrality. Among the responding CSDs there is an acknowledgment that running CSD services in a DLT environment will require the role of the CSD to change from centrally running all securities on its own books to operating a network and ensuring its integrity in a legal, technical and operational sense.
- Both financial market infrastructure operators and users agree that even if amendments may be necessary to realise the full potential of fintech in a CSDR environment, any **changes should be postponed until the lessons of the proposed Pilot Regime are known**. According to them, the Pilot regime should allow all stakeholders to gain insights into the use of DLT for market infrastructure and would then allow the legislation to adapt to the gathered experiences. However, one public authority took an opposing view and believes

[14] Proposal for a Regulation of the European Parliament and the Council on a pilot regime for market infrastructures based on distributed ledger technology, COM(2020) 594

that the proposed Pilot Regime Regulation does not solve adequately central issues related to the use of decentralised ledgers by CSDs.

3.5.1. *Applying CSDR requirements to DLT*

In total 37 responses were submitted with respect to specific issues (legal, operational, technical) related to the use of DLT within the CSDR framework. There was a clear split between groups of respondents, with financial market infrastructure operators believing that CSDR is not a barrier to the use of DLT, while users expressed greater concerns. Only with respect to the definition of "book entry form" and "dematerialised form" did a majority of respondents in both groups indicated it was not a concern. Still, the majority of respondents saw the CSDR framework as being technology neutral. The concerns are less related to the fact that CSDR may be incompatible with DLT, but rather more that guidance is necessary to make CSDR operational in a fintech context.

3.5.1.1. Definition of CSD and "securities settlement system"

According to several stakeholders, the definitions of a 'CSD' and a 'securities settlement system' (SSS) should be revised to allow regulated firms to operate a securities token SSS using DLT. This is because, according to them, a DLT platform might constitute an SSS under certain circumstances, but it may not necessarily be a CSD. Furthermore, obligations should be clarified under Article 39 of CSDR. Currently they only set out CSDs' obligations in the context of the SSS and equivalent measures should be clarified for a DLT environment.

3.5.1.2. Under which conditions records on a DLT platform can fulfil the functions of securities accounts

Respondents acknowledged that although CSDR defines a securities account, it does not clarify whether there is a legal difference between accounts, records and ledgers. In addition, it should be clarified whether the concept of 'wallets' is similar to accounts.

3.5.1.3. Definition of settlement

Several users believe that the current definition of a settlement (Article 2(7) of CSDR) is appropriate for DLT based settlement. Financial market infrastructure operators, however, pointed out that it should be clear when a DLT transaction can be considered final. They raised the issue whether a transaction that is "validated" (data recorded) on a DLT platform and results in a "transfer" of the token would meet the requirement of "settlement".

3.5.2. *DvP considerations*

Overall, respondents would welcome clarification on the possibility to use digital assets for Delivery versus Payment (DvP) from a legal perspective, noting that it would be interesting to assess the potential application of CSDR to asset-referenced tokens/e-money tokens in order to enable their use for DvP settlement of securities. Many

respondents had different opinions regarding the use of a security token or stable coin as means of payment. According to them, in the case of tokens, operational solutions might be utilised to achieve DvP and in the case of stable coins setting out minimum conditions would be necessary.

3.5.2.1. Internalised settlement considerations

According to the respondents, nothing indicates that internalised settlement in a DLT context would not be possible with the CSD acting as the network operator. Clarifications are however sought as to whether some crypto-asset platforms and blockchain protocols would qualify as SSS or settlement internalisers. Some respondents also questioned the benefits of internalised settlement in a DLT context.

3.5.2.2. Definition of "book entry form" and "dematerialised form"

A clear majority of respondents, representing both the operators and users of financial markets infrastructure, believed that the concept of book-entry form under CSDR appears to be workable in the context of security token settlement on a distributed ledger. Respondents noted that tokens that exist purely in digital form on a DLT platform are no different from 'dematerialised securities' that are issued straight to the screen in the existing systems. However, guidance should confirm that securities recorded on a distributed ledger fall within the meaning of securities issued in "dematerialised form" that fulfil book-entry requirements. Some individual respondents were however more concerned. One respondent pointed out that the definition of 'book entry form' is tied to the existence of a CSD, suggesting amendment of this strict requirement to allow for other regulated entities offering DLT-enabled security token issuance models to be listed and traded on stock exchanges and MTFs.

3.5.3. Ensuring technology neutrality of CSDR

Respondents were split when asked about potential changes to CSDR and its delegated acts to ensure their technology neutrality. A common message was that the regulatory obligations under CSDR should continue to apply in respect of all types of securities, including in digital forms. This is to ensure that the regulatory landscape remains technology neutral and does not treat those settling securities on a DLT platform in a more or less advantageous manner than those settling traditional securities. A few respondents indicated that existing terms and definitions, such as "securities account", "DvP", "cash leg", "settlement finality" or "safekeeping" should be analysed to ensure technology neutrality. **However,** there are **no urgent calls for action**. Even the respondents who expressed potential concerns about CSDR saw the Pilot Regime as the appropriate means to assess their concerns.

3.5.4. Book-entry requirements for crypto-assets that qualify as financial instruments

A clear majority agreed that book-entry requirements under CSDR are compatible with crypto-assets as financial instruments. Only six respondents believed otherwise, while

seven did not have an opinion. Financial market infrastructure operators reiterated their claim that as CSDR is in principle technology neutral it caters for existing and upcoming technologies. They claimed that book-entry accounts are technically also digital in nature and not physical accounts, so it is difficult to imagine why DLT addresses would not constitute accounts in the same way. Nevertheless, the exact requirements need to be looked at more closely to see if CSDR is compatible with decentralised functioning, in particular depending on whether the process is the same (entry of an owner) or different (one entry in one ledger or two entries, e.g. debit and credit, on two or more accounts in a custody chain). A minority of respondents (mainly public authorities) considered that making crypto-assets compatible with the book-entry requirements is challenging and requires further analysis.

3.5.5. Application of current rules in a DLT environment

37 respondents provided a reply. Users of financial market infrastructures were concerned about the applicability of CSDR rules to a DLT environment, while infrastructure operators were less so. Only in the case of: (a) rules on settlement periods, (b) rules on communication procedures with market participants and other market infrastructures and (c) rules on requirements for participation, were both sets of stakeholders overwhelmingly not concerned about the application of these rules in a DLT environment.

However, several respondents pointed out that while CSDR is technology-neutral, several Level 2 or Level 3 clarifications would still be required to ensure legal certainty to CSDs when performing their core activities using DLT.

3.5.5.1. Rules on settlement periods and settlement fails

Respondents generally believe that even with the application of DLT, settlement fails will happen (due to technology issues, mismatching, etc.) and hence rules on settlement periods, fails and participation modes (approval of participating actors) can be translated into code pieces and directly implemented on the smart contracts regulating the settlement operations.

According to several respondents, application of DLT would help settlement efficiency, but would not prevent fails. They could still arise in a DLT context, for similar reasons to traditional CSDs, and the operating entity should monitor them. One CSD also added that clarification would be needed to ensure that the requirements of Articles 6 and 7 of CSDR are applicable to DLT based securities.

3.5.5.2. Rules on communication procedures

Respondents claimed that it would be beneficial to clarify the meaning of ‘international open communication procedures and standards’ under Article 35 CSDR, citing DLT-based real-time data-sharing with nodes as an example. Furthermore, the majority of

respondents claimed that platforms must be interoperable and consideration should be given to promoting common standards that enabling interoperability.

3.5.5.3. Rules on requirements for participation

According to one respondent, rules on participation modes (approval of participating actors) can be translated into code pieces and directly implemented on smart contracts regulating the settlement operations. Others argued that a decentralised platform can be restricted to comply with the requirement of restricting CSD participation, there should be no inherent challenges with using a permissioned network in which only authorised parties can participate.

3.5.5.4. Organisational requirements for CSDs

According to some respondents, rules should support more efficient structures. It may be necessary to distinguish between privately and publicly controlled DLTs, as the former could possibly be considered as a form of outsourcing.

3.5.5.5. Rules on outsourcing of services or activities

According to certain respondents, clear guidelines must be established on the parameters and criteria for the outsourcing of CSD functions, and the roles the CSD must retain, or how some of the functions performed should be understood in a distributed environment or network. Not all providers may be capable of providing blockchain services to core aspects of securities settlement. This is why, according to one respondent, it would be necessary to prescribe requirements related to technical skills and experience to be able to provide outsourced services. In this context, respondents called for clear guidelines to be established on the parameters and criteria for the outsourcing of such functions, and what roles the CSD must retain. One respondent also argued that clarification would be needed regarding the circumstances in which entities involved in the validation function are to be covered by outsourcing requirements under Article 30 of CSDR. According to respondents, clear guidelines must be established on the parameters and criteria for what CSD functions may be outsourced, and what core roles a CSD must retain, or how some of the functions performed should be understood in a DLT environment.

3.5.5.6. Rules on the protection of securities of participants and those of their clients

According to one CSD, digital assets and technology would require a regulatory framework enforcing the highest standards of care. One other respondent argued that this is why the standard of care and liability of CSDs (Article 38 of CSDR) in protecting the securities of participants and of their clients in a digital context requires review.

3.5.5.7. Rules regarding the integrity of the issue

Several respondents claimed that reconciliation would be satisfied by means of real-time data sharing on a distributed ledger. One respondent added that the complexity of

decentralisation would require increased cooperation and equivalence across CSDs and the application of IOSCO standards may be useful.

3.5.5.8. Rules on cash settlement

Two issues were singled out. First, in a decentralised setting, it may be practically difficult to identify the country where the settlement takes place. Second, most CSDs offer settlement in central bank money, while presently central bank money is not directly issued on a distributed ledger. Therefore, according to respondents , to make settlement operational in a DLT environment settlement should be deemed to have taken place in the jurisdiction where the DLT operator is authorised. Furthermore, several stakeholders believed that regulators and central banks should ensure that DLT-platforms have the same level of central bank access, but also requirements as a traditional CSD.

3.5.5.9. Rules on requirements for CSD links

According to several respondents, interoperability between operators of financial market infrastructures should also apply in the context of DLT platforms. With regards to potential widespread use of blockchain, several respondents argued that participants and CSDs shall be connected in an interoperable manner. According to one respondent, the best way to achieve this would be to prescribe some technical standards through ESMA.

3.5.5.10. Rules on legal risks

According to several respondents, enforceability requirements applicable to CSDs and participants are clear and do not depend on the underlying technology. However, according to one respondent, some clarifications would be needed, e.g. it should be made clear which national law applies to each securities account in any holding chain. One respondent argued that although national laws and future EU proposals may consider a variety of factors regarding crypto assets a harmonised approach to security tokens would optimise legal predictability, including with respect to enforcement rights. Other respondents also noted that further challenges can be brought about by the fact that DLT technology allows for nodes to be dispersed around the world giving rise to possible enforceability issues should the node not be within the EU.

3.6. Authorisation to provide banking-type ancillary services

According to Article 54 of CSDR, the provision of banking-type ancillary services by CSDs is allowed either by themselves or through one or more limited license credit institutions, provided that some requirements are complied with in terms of risk mitigation, additional capital surcharge and cooperation of supervisors in authorising and supervising the provision of these banking services to CSD users.

3.6.1. Authorisation of CSDs to provide banking-type ancillary services pursuant to Article 54(3) of CSDR

Nine CSDs responded to the question of the targeted consultation inquiring whether they provide banking-type ancillary services, with the responses being evenly split. All CSDs that responded positively were providing banking-type ancillary services prior to the entry into force of CSDR; two have been already authorised under CSDR, two are in the process of being authorised and one has not been authorised yet.

The majority of CSDs consider that **the conditions set out in Article 54(3)** for the provision of banking-type ancillary services by CSDs are **proportionate and help cover the additional risks that these activities imply.**

However, other CSDs noted that the provision of banking-type ancillary services by CSDs is subject to **strict requirements that may not be proportionate to the risks and volumes of certain banking services** they intend to provide, especially in the case of smaller CSDs. It was also argued that certain asset services with a limited risk profile that could be mitigated through appropriate measures should be allowed without the need to require a banking licence.

Furthermore, certain CSDs referred to the need to **clarify the interaction between Sections B and C of the Annex of CSDR** that define respectively the non-banking type ancillary services that do not entail credit or liquidity risks and the banking-type ancillary services that entail such risks. More specifically, a CSD argued that CSDs without a banking licence may wish to **provide services referred to in Section B of the Annex** by setting up low-risk and very specific "payment facilitation activities", in which case **even if cash were involved, such activities should not be considered as falling within the scope of Section C as they would not entail credit or liquidity risks** (e.g. services to small issuers such as processing of corporate actions, including tax, general meetings and information services). Similarly, another CSD noted that the services contained in **Section C of the Annex might comprise activities where the CSD is not interposing in the financial transaction**, but needs some flexibility in order to provide its services. A public authority suggested that the distinction of CSD activities should be based on whether the CSD faces financial risks (i.e. credit, counterparty or liquidity risks) rather than on whether they are banking-type activities.

3.6.2. Main reasons CSDs may not apply for authorisation to provide banking-type ancillary services

CSDs provided various reasons for not seeking authorisation to provide banking-type ancillary services:

- CSDs may be **discouraged by the ecosystem of certain Member States** and the **high costs involved**. Regarding costs, a CSD noted that considering the fact that the vast majority of trades are settled in central bank money, there is no business

case for them to justify the cost and effort necessary to comply with the relevant CSDR requirements.

- For CSDs without a banking licence that are part of a group, there is a **lack of economies of scale** due to fragmentation and associated high costs.

- The **strict prudential requirements** have created a high-level structural barrier for entry to CSDs without a banking licence. On this point, industry associations of banks from a specific Member State warned against the negative impact on CSDs' participants of prudential requirements applicable to CSDs. This association noted that the current rules lead to processes (such as pre-funding obligations imposed on CSDs' participants) which create additional credit risks and reduction of liquidity of the CSDs' participants.

- Competent authorities in certain Member States consider **CSDs authorised to provide banking-type ancillary services** in accordance with Article 54 CSDR **as credit institutions** under the CRR. This **creates a complex regulatory environment with increased costs for regulatory compliance,** as CSDs have to comply with two distinct regulatory and supervisory frameworks. Potential inconsistencies across Member States on this issue might increase uncertainties as well as the operational burden.

It is however worth noting that certain stakeholders, mainly banks and their associations stated that any **amendments to the current rules should not result in a relaxation of the prudential requirements that apply to CSDs** wishing to provide banking-type ancillary services. According to these stakeholders, CSDs should remain adequately protected from any additional risks, such as credit or market risks, that are normally associated with the provision of banking services.

3.6.3. Designation of credit institutions to provide banking-type ancillary services to EU CSDs pursuant to Article 54(4) of CSDR

CSDs noted that no CSD in Europe has been able to make use of the option to appoint a designated credit institution to provide banking-type ancillary services as **no credit institution meets the conditions set out in Article 54(4)**.

Stakeholders expressed different views as to whether the requirements set out in Article 54(4) of CDSR for the designation of credit institutions to provide banking-type ancillary services to CSDs are proportionate.

Most EU CSDs and their association, as well as a public authority, consider that **the relevant requirements are disproportionate**. According to them, applying the same requirements as for CSDs with a banking licence to ensure a level playing field and prevent systemic risk reasons means that the rules unintentionally very strict. Two requirements were particularly mentioned:

- The requirement that the designated credit institution **does not itself carry out settlement, notary or central maintenance services** (Article 54(4)(c)). According to a group of CSDs, this requirement is too strict and disproportionate as it does not distinguish between cross-CSD banking services entailing credit and liquidity risks, and services for the cash management of securities that do not entail such risks. According to that stakeholder, if a CSD within a group has a limited banking licence, other CSDs within the same group should be able to designate it as a credit institution pursuant to Article 54(4).

- The requirement that the authorisation **be used only to provide the banking-type ancillary services referred to in Section C** of the Annex and not to carry out any other activities (Article 54(4)(d)). Certain stakeholders noted that there is no business case for a credit institution to be authorised pursuant to Article 54(4) if it can only provide services in support of CSDs' services, without the possibility of engaging in other activities. In this regard, a public authority stated its openness to enlarge scope of activities these entities could undertake to make their business model viable, noting however that any changes in this respect should take into account the risks that such other activities may generate for the designated credit institution and, eventually, for the CSD.

A few stakeholders **consider however that the relevant requirements are proportionate**. More specifically, a bank noted that such requirements reflect that settlement in central bank money is preferable to settlement in commercial bank money. As regards the requirement that the entity authorised to provide banking-type ancillary services cannot provide settlement, notary or central maintenance service, that stakeholder noted that it is necessary to avoid the risk of contagion. A public authority also expressed the view that the problems do not arise from Article 54(4) but from the thresholds set forth in Article 54(5) of CSDR.

3.6.4. Reasons for the lack of designated credit institutions pursuant to Article 54(4) of CSDR

Stakeholders provided various reasons for the lack of any designated credit institutions pursuant to Article 54(4) of CSDR.

- Certain public authorities and a bank referred to the **limited activity and the limited number of potential transactions** which means that such kind of credit institutions would not be economically viable.

- A CCP noted that the designated credit institution **needs to be authorised pursuant to Article 8 of Directive (EU) 2013/36/EU**, despite the fact that the services offered are much more limited.

- A group of CSDs noted that CSDs within the group that do no not have a banking license have opted to open accounts with foreign central banks for settlement in

foreign currencies. For this reason, those CSDs do not need to use the option of designating a credit institution to provide banking type ancillary services.

3.6.5. Provision of banking-type ancillary services by credit institutions below the threshold set in Article 54(5) of CSDR

The majority of stakeholders, including CSDs and their association as well as a public authority, **suggested a reassessment of the threshold set out in Article 54(5) of CSDR** under which a credit institution can provide banking-type ancillary services to a CSD without complying with the requirements of Article 54(4) of CSDR.

CSDs in particular noted that the threshold of Article 54(5) requires an adjustment according to the **reality of each CSD market profile and used currencies**. According to them, a one-size-fits-all solution is not adaptable to the different market sizes. A CSD stated specifically that the threshold prevents non-banking CSDs from servicing the issuance in a non-domestic currency.

Another CSD noted that the Article 54(5) threshold is **very sensitive to the turnover ratio of different bonds and that the turnover ratio for different CSDs differ**. More concretely, according to that stakeholder, this means that a CSD with a low turnover ratio (issuer CSD with smaller investor base) can issue a lot more before reaching the Article 54(5) threshold whereas a CSD with a high turnover ratio (having more investors, support collateral management) can issue a lot less before reaching it. Furthermore, above this threshold, it would not be possible to offer issuance to others in the same or other commercial bank money currencies. According to that CSD, this level of issuance would hardly cover the costs required to put the service in place and greatly restricts the business offering CSDs provide to their customers.

Another CSD argued that the criteria used in Article 54(5) are unclear as regards whether the volume should include the settlement only or also include the subscription, redemption and the corporate events. According to that stakeholder, NCAs have read the rules in the most restrictive way including all the flows, even though this, within the timeframe of a year, is not reasonable.

The following **concrete proposals for revising the thresholds** have been made:

a. As regards the threshold of 1% of the total value of all securities transactions against cash settled in the books of the CSD, the following suggestions were made by individual CSDs:

    - It should be increased to a percentage to be determined following an analysis that should be performed on different use cases gathered per market and according to the specific service risks and market profile.

    - It should be increased to 2% (for EU/EEA currencies) or 10% (for non EU/EEA currencies), per applicable currency.

- o It should be increased to 3%, taking into account settlement volumes and projected development of the market.

b. As regards the upper limit of 2.5 billion per year, individual CSDs suggested:

- o That it should be removed as a one-size-fits-all approach solution has proven to be inefficient.
- o It should be alternative and not cumulative to the aforementioned threshold.

In this context, to mitigate the risk from commercial bank settlement, a CSD proposed the following acceptance criteria for choosing a commercial bank: 1) a bank with European oversight; or 2) significantly important financial institution in the respective home country; or 3) credit rating higher than Aa2/A+ or similar.

Few stakeholders were **against revising the Article 54(5) threshold**. A group of CSDs stated that CSDs without a banking license within the group do not offer settlement in commercial bank money and have no intention of doing so in the future. That stakeholder also noted that any threshold should be set at a level where both the risk of default of the credit institution and the amounts at stake are low such that it does not jeopardise the smooth operation of CSD services, an argument also supported by a bank.

Few stakeholders **expressed no opinion to this question**. A bank noted that entities offering banking-type ancillary services, similar to that of credit institutions and/or CSDs, should be subject to equal scrutiny and regulatory requirements. A public authority stated that it could also consider a reassessment of the thresholds to the extent that this would be done carefully to avoid introducing significant credit and liquidity risks from those banking-type ancillary services in settlement mechanisms.

3.6.6. Settlement in other currencies

The majority of CSDs and their association (as well as issuers and a national association representing the financial sector) noted that they have encountered **difficulties where issuers request to issue a new instrument in a foreign currency** where the CSD:

- does not have a banking licence;
- cannot access the relevant central bank;
- cannot use a designated credit institutions pursuant to Article 54(4) of CSDR, as no such institution exists;
- cannot use a commercial bank, as the activity is above the threshold set in Article 54(5) of CSDR.

A group of CSDs noted that Article 54 of CSDR has unintendedly led to **cross-currency fragmentation** and **restricted access to liquidity** for CSDs without a limited purpose

banking licence, which makes CSDs' cross-border activity less likely. Consequently, CSDs can no longer service domestic issuance in other currencies, including sovereign debt.

A CSD also recalled that one of the key goals of CSDR was to promote competition among CSDs, to achieve ultimately a more efficient and attractive market. However, for prospective issuers (and investors) **the lack of choice of currencies that can be serviced by the CSDs** leads to the opposite outcome.

Regarding the **possibility to access a Central Bank**, a CSD noted that it **implies significant costs**, which differ significantly depending on whether the Central Bank is within or outside the EU/EEA, and **necessitates a significantly high level of volume to make it economically viable.** A group of CSDs noted that when there is a high demand for settlement in a specific currency and an account can be opened with the relevant Central Bank, CSDs within the group follow this practice. This group considers that the main difficulty does not arise from CSDR, but rather from the **formalities required to open an account in a foreign central bank**, and the **length of the process**. For example, another CSD noted that for most of the currencies (relevant and non-relevant) for which it offers credit, in most cases it is allowed to open an account with the relevant Central Bank only if it is locally incorporated, but in some cases it is not possible at all.

Furthermore, a CSD noted the **thresholds of Article 54(5) are too low** for the majority of European CSDs to be able to compete in the settlement in foreign currencies (see also section 3.1).

3.6.7. Proposals to facilitate settlement in other currencies

As to how settlement in foreign currencies could be facilitated for CSDs without a banking licence, stakeholders made the following suggestions:

- **Facilitate access to non-domestic central bank money, within the European Economic Area and third countries,** in line with Articles 40(2) and 59(4)(h) of CSDR, considering the specific regulatory requirements surrounding FMI operations. As such, CSDs suggested that the legislator enshrine the CPMI-IOSCO principle 9 on money settlements, which is dedicated to provide a safe and liquid settlement service.

- **Reassess the threshold and the percentage used in Article 54(5)**, as discussed in section 3.6.5 above.

- **Allow CSDs with a limited banking licence to be designated credit institutions, providing banking-type ancillary services to** more than one entity within the group or outside it, as discussed in Section 3.6.3.

- Facilitate **easy access to local CCP**, i.e. through active repo markets **or central bank liquidity.**

3.6.8. Other issues raised in relation to the provision of banking-type ancillary services

A public authority noted that the interaction of the review and evaluation process for core and non-banking ancillary services and for banking ancillary services when they are performed by different competent authorities should be clarified.

3.7. Settlement discipline

CSDR includes a set of measures to prevent and address failures in the settlement of securities transactions ('settlement fails'), commonly referred to as 'settlement discipline' measures. Application of the relevant rules in CSDR is dependent on the date of entry into force of Commission Delegated Regulation (EU) 2018/1229 on settlement discipline (RTS on settlement discipline).

The RTS on settlement discipline was supposed to enter into force on 13 September 2020. However, in May 2020 the Commission adopted a Commission Delegated Regulation amending it, thereby postponing its date of entry into force from 13 September 2020 to 1 February 2021. This short delay was considered necessary to take into account the additional time needed for the establishment of some essential features for the functioning of the new framework (e.g. the necessary ISO messages, the joint penalty mechanism of CSDs that use a common settlement infrastructure and the need for proper testing of the new functionalities). During the COVID-19 crisis, many stakeholders asked for a further postponement of the entry into force of the RTS. Those stakeholders argued that the COVID-19 pandemic impacted the overall implementation of regulatory projects and IT deliveries by CSDs and their participants and that, as a result of that, they were not able to comply with the requirements of the RTS by 1 February 2021. Following the adoption by the Commission of an ESMA proposal and subsequent non-objection by the Parliament and Council, the new date into application of these rules is 1 February 2022.

The response rate to this section was very high, with more than 98% of the respondents to the targeted consultation providing their feedback on some or all of the questions related to the settlement discipline.

In essence, **a large majority of the re**spondents, including public authorities, CSDs, CCPs, banks, asset management companies, market makers, and their respective associations**, considered that the settlement discipline framework should be reviewed**. From those respondents:

- A vast majority indicated that the rules related **to buy-ins** should be reviewed**,** with a large majority (all categories of stakeholder included) in favour of voluntary buy-ins;
- More than half of the respondents considered that the rules on **cash penalties** should be reviewed;

- Only a few respondents, mainly CSDs, a couple of banks and one public authority, favoured a revision of the **rules on settlement fails reporting**, although very few of them provided further feedback and those who did indicated almost exclusively that there is a clear need for ESMA guidelines on settlement fails reporting to clarify the rules;

- Almost a third of stakeholders replying to this question considered that other settlement discipline requirements (such as rules concerning the sending of written confirmations, rules on the suspension of participants consistently and systematically failing to deliver securities) should be reviewed;

- Only few CSDs and one association representing clients considered that all the requirements related to the settlement discipline should change.

3.7.1. General remarks

Many stakeholders, including public authorities, CSDs, banks and their associations raised a number of issues relating to the timeline including:

- **Links between the current implementation timeline of the settlement discipline framework, and the implementation of any changes emerging from the review of CSDR**. Some expressly asked the Commission to further postpone the entry into force of the settlement discipline regime. These respondents fear that a misalignment between the current date of entry into application of the RTS on settlement discipline (1 February 2022) and changes emerging from the CSDR review would put them in a situation where they have made all the necessary investment to start applying rules which might subsequently change.

- Other respondents asked the Commission to **split the entry into application of cash penalties and buy-ins**. These respondents suggested that already **the entry into application of cash penalties will significantly increase settlement efficiency** and that an analysis of data on settlement fails following the application of this measure will help build a more suitable buy-in regime. Two asset management companies further suggested evaluating through expert groups composed of relevant authorities, CSDs, depositories, market participants and associations, the efficiency of a settlement discipline regime based on cash penalties only. This would ensure that mandatory buy-ins would apply only if cash penalties alone prove inefficient.

- Other respondents (mainly CSDs and issuers) indicated that CSDs have already started implementing the necessary IT changes to comply with the settlement discipline rules. They asked the Commission to keep changes as limited as possible and to ensure a coherent timeline avoiding changes. However, these same respondents ask the Commission to be attentive to the

views of the industry on concerns related to the implementation of the mandatory buy-in regime.

- Finally, one national industry association (representing mainly banks, asset management companies and issuers) invited the Commission to take into consideration the decision of the United Kingdom not to implement the settlement discipline rules by reviewing further the actual implementation timeline in the EU to facilitate a smooth application of the regime.

3.7.2. Mandatory vs. voluntary buy-ins

CSDR introduced mandatory buy-ins, compulsory enforcement of the original agreement between counterparties, as a way to address settlement fails. Very few respondents (some CSDs, one bank and one public authority) favoured mandatory buy-ins over voluntary buy-ins. According to some of these respondents, voluntary buy-ins already exist in bilateral contracts however they are not used by market participants to avoid harming business relationships with the failing counterparty who is often a major broker or bank. Furthermore, according to these respondents, **reducing the causes of settlement fails is possible**, as most settlement fails are due to operational deficiencies in back offices, where insufficient operational post-trade capacities may result in incorrect settlement instructions. These respondents indicated as well that the **current operational costs of managing settlement fails are significant**. Mandatory buy-ins would therefore also reduce overall costs by incentivising greater post-trade capacity which, in turn, would reduce settlement fails. According to these respondents, mandatory buy-ins would also **benefit retail investors by providing certainty on the delivery of their purchases**. One of these respondents highlighted that the Short Selling Regulation (SSR)[15] introduced mandatory buy-ins for centrally cleared equity transactions. The market quickly adopted them without significant turbulence and today settlement efficiency on intended settlement date for centrally cleared equity transactions reaches almost 100% according to this respondent. Finally, one of these stakeholders, although in favour of mandatory buy-ins, suggested that **it is necessary to modify extension periods for corporate and government bonds by giving more granularity and reflecting the liquidity of these instruments.** This proposal was also made by other respondents who were against mandatory buy-ins.

A **majority of respondents though** (representing banks, some CSDs, their associations and certain public authorities), **considered that buy-ins should be voluntary instead of mandatory**. Stakeholders in favour of voluntary buy-ins highlighted the following negative impacts on markets if buy-ins were to be mandatory for all types of instruments:

- **Mandatory buy-ins may reduce market liquidity**. According to many stakeholders (including asset management companies, banks, electronic trading venues and their associations) mandatory buy-ins would reduce liquidity

[15] Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps

particularly in new or low liquidity instruments. Fears on the operational complexity and the costs of mandatory buy-ins would reduce the willingness of liquidity providers to offer prices when they do not have ready access to inventory or for securities which cannot be readily sourced. Furthermore, according to some banks, due to mandatory buy-ins, in some extreme cases, market makers might have to retreat from some markets and instruments which are not sufficiently liquid.

- **Mandatory buy-ins may increase the costs for investors.** According to an important number of respondents (including asset management companies, banks, electronic trading venues and their associations) by trying to improve the settlement rates of a relatively small but important percentage of trades, market makers would have to adjust the pricing of trades, widening bid-offer spreads, leading to increased costs for investors and issuers. The impact of this cost adjustment would be particularly pronounced for less liquid instruments (which are more likely to be bought-in). One industry association further submitted that if mandatory buy-ins applied under normal market conditions, the possible increase in spreads in exchange traded products tracking the most impacted market segments would be of around 5-10 bps. Also, the costs of appointing a buy-in agent were specifically mentioned by some respondents.

- **Mandatory buy-ins may lead to sub-optimal consequences for investors**. Several banks, asset management companies and their industry associations submitted that the cash compensation where the buy-in is not possible does not grant the outcome that parties have contracted for in the beginning of the trade and it is suboptimal in many cases (e.g. where the buyer is also the seller on an underlying transaction, it would be better to have the flexibility of a longer buy-in period to get the security). They further submitted that cash compensation creates additional risks, and potential costs, not only for liquidity providers, but also for investors (e.g. risks and costs for the non-failing party in case that the cash compensation is set at a level lower than their tolerance to what constitutes fair market value, and the impact this might have on their books). Furthermore, it may impact corporate action eligibility, raise tax issues and have a direct impact on investment funds Net Asset Value (NAV) calculation with significant consequences on investment funds. These respondents also raised concerns about the methodology outlined in the RTS on settlement discipline for determining cash compensation for bond markets. They suggested that if buy-ins were to remain mandatory, cash compensation should be negotiable between the parties, rather than enforced and determined by a prescriptive methodology.

- **Mandatory buy-ins would create an unlevel playing field for EU CSDs**. CSDs, some banks, asset management companies and their associations indicated that, when competing with third-country CSDs without such regime, mandatory buy-ins would create an unlevel playing field for EU CSDs.

- **Mandatory buy-ins may negatively impact securities lending and repo markets**. An industry association representing asset management companies and some banks, submitted that buy-ins may remove incentives to lend securities in the lending and repo markets, especially if entities holding securities, currently engaged in lending, may fear that if they sell the securities and there is a delay in the return, the outright sale would be subject to mandatory buy-in costs. The fear of being subject to a mandatory buy-in would reduce the willingness to participate in these markets and the liquidity thereof.

Many of these respondents have also indicated that by changing the nature of buy-ins from mandatory to voluntary, other concerns expressed by them in other sections of the targeted consultation would fade away (e.g. the scope of buy-ins and concerns related to buy-in agents).

A few stakeholders (mainly banks and their associations) provided **further quantitative evidence on the expected impact of mandatory buy-ins in markets**. The quantitative evidence provided focused on **bond markets**. It illustrated the concerns that have been raised by numerous stakeholders on the expected impacts on market liquidity and costs for final investors. According to confidential data provided, the difficulties related to the pricing of mandatory buy-ins (e.g. calculations of the probability of fails lasting longer than the extension period, price of securities purchased through the buy-in process rather than on markets based on availability of likely low liquid securities, penalties being applied until the end of the buy-in process) would widen bid-ask spreads, reduce liquidity on those instruments which are more prone to settlement fail (due already to their relatively low liquidity) and would make trades on every instrument more expensive.

It is worth noting however that one of the stakeholders who favoured mandatory buy-ins submitted, in contrast to stakeholders against mandatory buy-ins, that the widening of bid-ask spread in less liquid instruments as a consequence of mandatory buy-ins increases market transparency. This stakeholder expects that market makers will be able to improve sourcing and will continue to act competitively, minimising a potential negative effect.

Most of the respondents expressing views against mandatory buy-ins considered that **cash penalties will help achieve the improvement in settlement efficiency** sought by the co-legislators in CSDR.

3.7.2.1. Buy-in rules differentiated depending on markets, instruments and transactions types

Almost all stakeholders providing feedback, were in favour of buy-in rules that take more into consideration the characteristics of the markets, the instruments or the type of transaction. More specifically, many stakeholders (including public authorities, one market maker, banks, asset management companies and their associations) indicated that rules on buy-ins should take into consideration in particular the liquidity of instruments. However, one stakeholder submitted that buy-ins are already differentiated depending on

the liquidity of the instrument and that any further differentiation should consider more granular data to determine the classification.

However, some of these respondents (mainly banks) warned about overly prescriptive rules. According to them, the CSDR buy-in rules should be simplified considerably.

One bank submitted that the rules on buy-ins should recognise the role of market makers in supporting trading activities on less liquid markets.

3.7.2.2. Pass-on mechanism for buy-ins

A vast majority of stakeholders, all categories included, favoured a "pass-on" mechanism for buy-ins, which would allow settlement fails along the same chain to be solved by one buy-in in the original settlement fail which provoked the other fails.

- Almost all of them agreed that a **pass-on mechanism would reduce the number of buy-ins** required to remedy settlement fails and some of them considered that it would **contribute to market stability**.

- A pass-on mechanism was also seen by some banks as a way to **reduce unintended negative consequences of mandatory buy-ins**.

Several respondents provided feedback on the application of the "pass-on" mechanism:

- One bank supported a pass-on mechanism applicable to a scope of instruments and transactions wider than the scope of the rules on the execution of buy-ins. According to this respondent, a party who fails to deliver because it has not received securities from a third party should be able to pass on the costs of any buy-in to that third party.

- Due to the complexity of implementing a pass-on mechanism and the need for flexibility, certain stakeholders (mainly banks, asset management companies and their associations) warned that rules on the pass-on should not be prescribed in detail in legislation but agreed among the industry. They preferred that the legislation set the right to benefit from a pass-on as well as some high level principles and leave it to the industry to organise itself.

- One industry association representing participants in the lending business however warned that a pass-on mechanism might not be feasible or might be ineffective as part of the current regime, without also addressing the rigidness in timing of when a buy-in is initiated and the asymmetry in price differentials.

3.7.2.3. Rules on the use of buy-in agents

A large majority of respondents, all categories included, was in favour of amending the rules on the use of buy-in agents. Many of them (banks, asset management companies and their associations as well as public authorities) specifically suggested the **removal of**

the obligation to appoint a third-party buy-in agent. The main concerns raised by respondents with regards to these rules are the following:

- The rules are seen as **very rigid and inefficient, as they lead to longer time to achieve the expected goal**. Some stakeholders (mainly banks, asset management companies and their associations) raised concerns about the **limited number of third-party buy-in agents** available and the quasi-monopolistic situation that this creates. Several respondents further expressed concerns on the **high cost of buy-in agent services**.

- One asset management company further submitted that due to the costs and risks linked to the role of buy-in agents, market-makers traditionally acting as buy-in agents for specific instruments have withdrawn from providing buy-in services.

- One central bank further warned about the **additional risk that instructing a buy-in agent may create, especially when the buy-in agent requires the non-failing party to prefund it**.

Some respondents (mainly banks) proposed that a **counterparty to a trade should be able to act as buy-in agent for itself**, while other respondents suggested that **parties set out the provisions in their contractual arrangements** (similar to their suggestion to make buy-ins voluntary). One central bank suggested that the use of a buy-in agent should not be mandatory and **that non-failing parties should be given the choice to enter into a substitute purchase and claim any additional costs and fees incurred from this substitute purchase**.

The only respondent favouring the current rules on buy-in agents highlighted the **advantages of having a neutral third-party without conflict of interests executing the buy-in**.

3.7.2.4. Asymmetry in the reimbursement for changes in market prices

The settlement discipline rules provide for the payment of the price difference in case of mandatory buy-in only by the failing party when the price paid in the buy-in is higher than the price agreed at the time of the original trade. If the price paid in the buy-in is lower, then the difference is deemed paid. A majority of respondents, all categories included, consider that this **asymmetry in the reimbursement for changes in market prices should be eliminated**. One asset management company submitted that **the current asymmetry prevents any resort to a pass-on mechanism and might bring opportunistic behaviours from market participants**.

Other stakeholders (namely a CSD and a public authority) however submitted that **the asymmetry prevents failing participants from making a profit out of a fail when prices drop** and is therefore consistent with the overall objective of reducing settlement fails.

Finally, certain respondents (including a CSD, some banks and their associations) considered **that there is no evidence to evaluate the advantages and disadvantages of the asymmetry** and therefore an analysis of the impact could be done only after the entry into force of the rules.

3.7.2.5. Scope of the buy-in rules

Most of the issues identified by stakeholders in their responses to the section on the scope of CSDR (Section 6 of the targeted consultation) concerned the scope of the settlement discipline rules. This section of the feedback statement provides further details on the issues identified with regards to entities, transactions and instruments within the scope of rules on buy-ins as well as the geographical scope of these rules.

There is **almost unanimity** among stakeholders on the fact that **the scope of the buy-in regime should be clarified and/or reviewed**.

From the responses to the targeted consultation, the following aspects of the scope of the buy-in rules seem to merit clarification or further refinement.

- **Types of securities covered by the buy-in rules**

Several stakeholders, including CSDs, banks and their associations, suggested the creation of a central database (i.e. a golden source) for securities within the scope of the settlement discipline (i.e. helping identify easily the reference price, the penalty rate, the extension period and whether or not buy-ins apply). Many of these stakeholders suggested that ESMA should be mandated with establishing such a database.

- **Scope of entities concerned by the buy-in rules**

Various stakeholders suggested introducing exemptions from the buy-in rules for the following actors:

a) **Retail clients**: Some stakeholders (mainly banks) suggested clarifying that buy-in rules only apply to regulated entities. One of the respondents specifically highlighted that the complexity of the buy-in process, the documentation required and the level of understanding of the market required, make buy-ins inappropriate for retail investors.

b) **Custodians and settlement agents**. An industry association representing banks, suggested that buy-in rights and obligations should be placed on the trading parties, and not on the receiving and delivering CSD participants.

c) **Market makers.** An industry association representing market makers submitted that market makers should benefit from an exemption to mandatory buy-ins as is the case in other jurisdictions.

- **Transactions within the scope of the buy-in rules**

Among stakeholders who preferred **voluntary buy-ins**, many of them (including banks, asset management companies, their associations and some public authorities) specifically ask that voluntary buy-ins be limited **trades not cleared by a CCP**. According to them, transactions cleared by CCPs should remain subject to mandatory buy-in rules. However, one stakeholder explicitly indicated that the flexibility of voluntary buy-ins should also be provided for cleared transactions, where the rules of CCPs should govern buy-ins. Furthermore, CCPs warned about potential disincentives for clearing if certain instruments (e.g. bonds) are subject to voluntary buy-in arrangements in the non-cleared sphere while these same instruments remain subject to mandatory buy-ins in the cleared sphere.

Furthermore, a number of stakeholders (mainly banks, asset management companies and their associations) asked for **all or some of the following transactions to be excluded from the scope of buy-in rules**:

a) **Primary market transactions (for bonds, equities, ETF and other funds)**. Some stakeholders submitted that the finalisation of the initial issuance depends on conditions that are usually not related to the settlement discipline of a trading participant, but on technical and legal procedures (such as the publication of a prospectus). According to them, buy-ins in these cases would be disruptive without any discernible benefit. More specifically, in the case of exchange traded products, a stakeholder explained that if a buy-in was triggered concerning a transaction of a newly created unit, the buy-in agent would have to acquire the unit of the exchange traded product from a different authorised participant. If the units are not readily available, the authorised participant may need to subscribe for the units with the original provider creating a circular scenario.

b) **Transactions where the ownership does not change**, (e.g. portfolio transfers, where a client may choose to transfer a position from one custodian to another).

c) **Corporate actions**, including market claims on securities, as these already represent and adjustment of a pre-existing transaction on a security. Some stakeholders submitted that existing buyer protection measures should prevail in these cases.

d) **Securities financing transactions**, which are already covered by clear contractual **terms that include legal remedies in the event of settlement fail**. Furthermore, some stakeholders submitted that the buy-in in the case of securities financing transactions would make no sense from an economic or risk mitigation perspective. However, one stakeholder suggested that the introduction of a pass-on mechanism would allow for the inclusion of securities financing transactions in the scope of buy-ins.

e) **Physically settled derivative transactions**. Some industry associations have submitted that mandatory buy-ins would distort the long-standing industry standards on commercial agreements between trading parties.

f) **Margin transfers** (designed to achieve credit risk mitigation in respect of the underlying trade between trading parties), should also be excluded from the buy-in rules according to almost all the respondents having provided feedback on this point. The stakeholders argue that the objective of the buy-in (receiving a specific security) would make no economic sense in the settlement fail of a margin transfer. Buy-ins could have a detrimental impact (e.g. exposing the receiver to additional risks when initiating the buy-in and pre-funding the buy-in agent and other necessary steps of the buy-in).

g) Some stakeholders (including banks their associations and a public authority) further suggested that buy-ins should **only apply to transactions between trading parties in secondary markets**.

h) One central bank suggested that rules on buy-ins should not apply to **collateralisation for Eurosystem credit operations**.

- **Geographical scope of the buy-in rules**

One bank submitted that the geographic scope of the buy-in rules is too broad, as these rules may apply globally. Therefore, according to this bank, they enter into conflict with third-country rules. These conflicts will be a major source of legal uncertainty according to this stakeholder. In addition, a group of stakeholders representing central banks, CSDs and their participants, submitted that the current CSDR approach of influencing trading behaviour via buy-in rules on settlement transactions in EU CSDs inherently carries the challenges of lack of clarity and unintended consequences in terms of geographical scope (as trading parties are affected if their transaction settles in an EU CSD). Furthermore, one central bank requested that the application of the buy-in rules to transactions between two Union counterparties, settled through a third-country CSD are clarified.

3.7.3. Rules related to cash penalties

3.7.3.1. Procyclical effects of cash penalties

Concerning the potential procyclical effects of the cash penalties framework, the response rate was slightly lower compared to other questions related to settlement discipline. Views were split.

More than half of the respondents to this point, all categories included, agreed that the **cash penalties regime could have procyclical effects**. However, few respondents provided further information to justify their response on the potential procyclical effect.

Amongst those respondents who provided further feedback, less than half of them (including banks, asset management companies, their associations and one market

maker) submitted that cash penalties would have procyclical effects whereas the others (including CCPs, banks, asset management companies and their associations) held the opposite view. One public authority submitted that it is too soon to know whether cash penalties would have any procyclical effect.

An industry association representing CCPs pointed out that CCPs have had penalty frameworks in place for years and that no adverse effect has been observed during the market turmoil provoked by Covid-19. This **existing experience with cash penalties would point towards a very limited or no impact**.

3.7.3.2. Cash penalties rates

A considerable number of stakeholders (all categories included) considered that the penalty rates should be revised. The main issues raised by respondents were:

- A dynamic approach to calculating cash penalties: Some stakeholders (some CSDs, banks and their associations) noted that, after the entry into force of the cash penalties, some targeted amendments should be introduced to ensure that **cash penalties rates can evolve dynamically** with a concrete objective of settlement fail reduction. This type of adjustment of the cash penalties rate should take into consideration the settlement efficiency and the liquidity of different securities.

- Considering specific structural issues faced by ETFs: Other stakeholders (banks, asset management companies and their associations) indicated that cash penalties should take into consideration **structural issues faced by ETFs** (due to some "inevitable" realignments between CSDs according to respondents), which make it difficult to reach a high level of settlement efficiency.

- Considering ECB negative deposit facility rate: One central bank suggested **increasing the penalty rates to take account of the fact that the penalty payable by the failing party is lower than the expenses incurred by the buyer if the funds are kept in an account with a central bank and the deposit facility rate of the ECB** (-0,5%) continues to apply. Furthermore, one industry association representing CCPs submitted that the cash penalty calculation methodology for bonds should better reflect negative rates.

- Clarifying application of civil law claims: According to one central bank, under civil law, the buyer can claim reimbursement for expenses from the failing seller. However, this central bank (as well as a limited number of other banks responding to the targeted consultation) raised **questions on whether the penalty regime applies exclusively** (and hence the buyer would be prevented from claiming such reimbursement and be left with a loss), **or inversely, claims under regular civil law are still possible** even though the settlement discipline regime applies.

- Impact of different penalty rates calculation approach and process: One industry association representing banks submitted that the different approach and process with regards to cash penalties in the cleared and the uncleared markets leads to higher costs and unnecessary complexity in the entire market. Another industry association representing banks further suggested that cash penalties should be calculated at the same rate for all types of transactions and should not be dictated by the trading venue or the instruction type.

- Process of collecting and redistributing cash penalties when a CCP is involved: Several stakeholders, in particular industry associations representing CSDs, CCPs and banks, suggested that the **process of collection and redistribution of cash penalties is amended** to ensure that **one single party processes the collection and distribution of cash penalties**. This would imply an amendment to Article 19 of the RTS on settlement discipline. These stakeholders submitted that a duplicative operational process as foreseen in the RTS could create important new risks, particularly cross-border. A single operational process would therefore be preferable according to them.

- A single source of information for the calculation of cash penalties: CSDs and one industry association specifically suggested that a **single source of information for the calculation of cash penalties is created**. This goes in line with other submissions generally in favour of a golden source of information with regards to instruments in scope of the settlement discipline.

3.7.3.3. Scope of cash penalties rules

When asked specifically about the scope of cash penalties, as with the responses to the buy-in rules, a majority of respondents considered that the cash penalty regime would merit clarifications and or amendments in order to exclude some entities and/or transactions from its scope.

i. Scope of entities concerned by the cash penalty rules

When it comes to entities under the scope of cash penalties, several stakeholders (mainly banks) submitted that **retail clients should be excluded from the scope of cash penalties**. These stakeholders submitted that rules on cash penalties refer to CSD participants and failed transactions and aim at stimulating settlement efficiency.

ii. Scope of transactions concerned by the cash penalty rules

Several respondents (mainly CSDs, banks and their associations) submitted that **cash penalties should not apply to certain types of transactions,** such as: portfolio transfers, realignment transactions between markets, borrowing and lending transactions, collateral transfers, generally transactions outside the control of the participants (e.g. T2S realignment operations and T2S auto-collateralisation transfers), corporate actions on stock, primary market transactions, and creation and redemption of fund units.

One bank suggested that settlement fails of **transactions between two counterparties of the same corporate group should be excluded from the cash penalty rules** as the cash penalty would serve no economic purpose.

One industry association representing banks further requested that **the insolvency of the failing trading party should stop the cash penalties** (otherwise the receiving trading party would continue to receive the penalty from the failing participant who would not get reimbursed by the insolvent trading party).

iii. Geographical scope of the buy-in rules

On the geographical scope of cash penalties, one central bank expressed a preference for a **geographic scope of the cash penalties rules (as well as the buy-in rules) in line with the issuer CSD jurisdiction**.

3.7.4. Rules on the reporting of settlement fails

Several stakeholders, mainly CSDs, noted that there are many aspects of the rules of reporting of settlement fails that need to be clarified. Stakeholders indicated that they expect this to be solved through the ESMA's Guidelines on reporting of settlement fails.

3.7.5. Potential impacts during Covid-19 if the settlement discipline regime had been in place

As described above, several stakeholders have submitted that mandatory buy-ins would generally have detrimental impacts on the liquidity, the bid-ask spread and the final costs for investors. This is understood to be the case in normal market conditions and for less liquid securities. Respondents were given the chance to provide their views about the potential impact of the settlement discipline on the markets if it had been in place during the market turmoil provoked by the Covid-19 pandemic in the first half of 2020.

More than half of respondents, all categories included, considered that the **CSDR settlement discipline regime would have had a significant negative impact on the market if it had been in place during the market turmoil provoked by Covid-19**. Most of them focused their responses on mandatory buy-ins and further specified the following negative impacts:

- **Increased liquidity pressure**: Some of these stakeholders submitted that mandatory buy-ins would have added liquidity pressure, workload and operational risks with very detrimental consequences not only during the market turmoil but also afterwards, making the recovery more difficult.

- **Increased cost of securities at risk of being bought-in**: Based on confidential quantitative evidence shared with the Commission by some stakeholders, volumes of buy-ins in corporate bonds would have likely more than doubled during the Covid-19 market turmoil compared to normal market conditions, with a very high cost for securities being bought-in or at risk of being bought-in. These

stakeholders argued that the increase on the number and volume of buy-ins at a time when markets were under significant stress could have had severe consequences for Europe's bond markets in general, aggravating systemic risk.

- **Hampering the ability to hedge:** In the specific case of funds, one industry association, submitted that during the market turmoil provoked by Covid-19, due to outflows on open-ended funds, other portfolios were rebalanced to hedge against the market turmoil, which placed an important pressure on the liquidity of fixed income markets. According to this respondent, mandatory buy-ins would have exacerbated liquidity pressure and made it more difficult to hedge against the market turmoil with negative consequences for investors.

Finally, one CSD submitted that publicly available data shows[16] that most settlement fails during the market turmoil provoked by Covid-19 were solved within the extension periods. Therefore, according to this stakeholder, extension periods are calibrated accurately and seem to be fit-for-purpose even in a crisis scenario with increased levels of settlement fails. This stakeholder further submitted that the corporate bond market is less affected by the settlement discipline regime as buy-ins in this type of instruments represent a small fraction of buy-ins (based on settlement failed not solved before extension periods). According to this stakeholder there is no risk of serious impact with regards to the financing of the economy.

Concerning the impact of cash penalties, the Commission has received limited feedback on their potential impact if the rules had been in place during the recent market volatility in March 2020. Some stakeholders expressly indicated that the impact would have been negative but limited compared to the impact of mandatory buy-ins.

3.7.6. Other elements of the settlement discipline regime

Concerning other elements of settlement discipline, not explicitly mentioned in the questions, respondents raised the following issues:

- **Written allocation and confirmation**: several banks and their associations raised concerns regarding the rules on allocation and confirmation processes. They indicated that the requirement to send a confirmation of receipt of the written allocation and of the written confirmation within two hours would introduce unnecessary complexity with limited added-value and in an existing and efficient process.

- **Consistent and systematic failure to deliver securities**: some stakeholders, mainly banks, indicated that the rules related to the efficiency of participants in Article 7(9) of CSDR and in Article 39 of the RTS on settlement discipline are unnecessarily punitive and should either be removed or amended.

[16] "ESMA report on trends, risks and vulnerabilities", No.2, 2020, European Securities and Markets Association, ESMA-50-165-1287

Amendments suggested would include the introduction of some fixed tolerance thresholds (e.g. a minimum number or volume of failed transactions or a certain period of time under which a participant would never be considered consistently and systematically failing) or redrafting in order to ensure that it does not affect settlement agents or sub-custodians who are not principal to the transactions.

- **Suspension of the settlement discipline measures in case of emergency situations**: A few respondents suggested the possibility of creating a mechanism that would allow suspending the settlement discipline regime in certain emergency situations (similarly to the existing mechanism on the suspension of the clearing obligation). Another stakeholder, a bank, suggested introducing an exemption from cash penalties during market turmoil.

- **Civil law nature of cash penalties**: Several banks suggested clarifying the civil law nature of cash penalties to avoid legal uncertainty and issues arising with respect to tax law.

- **De minimis thresholds for cash penalties**: One asset management company suggested the introduction of a 'de minimis' threshold under which a penalty will not be collected.

- **Minimum claimable value of late penalties**: One industry association suggested introducing minimum claimable value of late matching and late settlement penalties between counterparties, where penalties have been imposed on a party through no fault of their own.

3.8. Framework for third-country CSDs

According to CSDR, third-country CSDs may provide their services in the EU, including through setting up branches in the territory of the EU. However, whenever a third-country CSD intends to provide notary and central maintenance services related to financial instruments governed by the law of a Member State or where it intends to provide its services in the EU through a branch set up in a Member State, the CSD should apply for recognition to ESMA. Other services (including settlement services) do not require recognition by ESMA under Article 25 CSDR.

The recognition process is only triggered once there is an equivalence decision issued by the European Commission in respect of a particular third country. In the meantime, according to Article 69(4) of CSDR, third-country CSDs can continue providing services in the EU under the national regimes.

24 stakeholders, including NCAs, industry associations and CSDs responded to the section of the consultation inquiring about the CSDR third-country CSDs framework.

3.8.1. Use of services of third-country CSDs

Only one stakeholder, a national association representing the financial sector, stated that its members use the services of a third-country CSD. More specifically, as UK CSDs provide services for certain securities that are not traded in other markets, some members use those services for portfolio and liquidity management, trade, settlement and custody services. From the rest of the respondents, six confirmed that they do not use the services of a third-country CSD whereas 14 did not express an opinion on this matter.

3.8.2. Grandfathering clause of Article 69(4)

Regarding the option to **introduce an end-date to the grandfathering provision of Article 69(4),** the large majority of respondents did not have an opinion on this question; among the limited number who responded, **opinions were split**. Some stakeholders, including NCAs and certain EU CSDs, **supported the introduction of an end-date** arguing, amongst others, that currently third-country CSDs can continue to service EU securities even though they comply with rules which have not been determined as equivalent by the Commission. As **to what that end date should** be, two suggestions were made:

(a) the time required for the European Commission to conduct an equivalence assessment following the third-country CSD's indication that it wants to apply for recognition to ESMA; or

(b) the date of the entry into force of the settlement discipline regime, in order to avoid that market participants use CSDs that are not subject to that framework.

Other stakeholders, mainly a couple of NCAs and third-country CSDs expressed their views **against amending the current grandfathering framework**. They argued that this would create legal and financial uncertainty for third-country CSDs if they are not recognised by the end of the grandfathering period, which would introduce unnecessary risk to the market. It was further noted that the grandfathering clause is applicable only to few third-country CSDs that were already active in the EU market and who have indicated vis à vis the EU authorities that they wish to continue offering their services in the EU.

Amongst those stakeholders that expressed no opinion, certain EU CSDs called for the **application of the proportionality principle**. They submitted that where a third-country CSD and its home authorities do not take the necessary steps to ensure equivalence, third-country CSDs should not be allowed to continue providing CSD services in the EU without being bound by equivalent rules. In that case, EU authorities should have the possibility of ending grandfathering for the third-country CSD and a careful assessment to weigh the benefits and the drawbacks of this decision would need to be conducted.

Concerning the introduction of a **requirement** for third-country CSDs operating under the grandfathering clause **to inform the competent authorities of the Member States where they offer their services and ESMA**, **most stakeholders expressed no opinion**.

Amongst those who responded, the views were split. Some competent authorities and EU CSDs were **in favour of introducing a notification requirement** since, under the current rules, the European Commission and ESMA may not be aware that a third-country CSD provide services with respect to securities constituted under the law of a Member State. Other stakeholders (including some CSDs) were **against the introduction of such a notification requirement**. They noted that the third-country CSDs that benefit from the grandfathering clause continue to provide their services under the national laws that were in force before the entry into force of CSDR and, according to them, those third-country CSDs are required to notify local authorities. A third-country CSD also noted that such notification requirement is not necessary as, when applying for recognition, a third-country CSD must notify ESMA in which EU Member States it wishes to offer or continue offering its services. It was also suggested that any notification requirement to ESMA should be ensured by local competent authorities of the Member States.

Stakeholders generally agreed that, in the absence of a notification requirement to EU authorities, **EU issuers could be asked to inform the European Commission or ESMA** of the fact that they use a third-country CSD for the recording of their securities in book-entry form.

3.8.3. Level playing field between EU and third-country CSDs

A clear majority of stakeholders, including competent authorities, CSDs and their association, an asset management company and an association representing asset management companies considered that there is or may be an unlevel playing field between EU and third-country CSDs.

In this respect, when assessing equivalence, the Commission was invited by respondents to place a strong emphasis on ensuring that the **EU and third-country regulatory regimes provide for a level playing field** between EU and third-country CSDs. Third-country CSDs for which an equivalence decision is granted should be continuously monitored to ensure that equivalence is revoked if needed. At the same time, stakeholders underlined the importance of **reciprocity** when deciding whether to award equivalence to a third country. While the EU has set out a framework for the provision of services by third-country CSDs, that may not be the case in certain third countries where local CSDs are the only providers of core services to issuers and the entry of foreign CSDs (by law or practice) is not allowed, particularly for shares.

Furthermore, certain stakeholders, including a competent authority, a CSD and an asset management company noted that competitiveness concerns may become more acute when the **settlement discipline regime** enters into force. A CSD further submitted that another source of unlevel playing field between EU and third-country CSDs is that

recognised third-country CSDs may provide their services in all EU Member States, without the complex passporting requirements that apply to EU CSDs.

Regarding in particular the **impact of the rules for third-country CSDs on the operations of ICSDs**, certain CSDs raised the concern that, if third countries also require some type of recognition for EU CSDs that offer services in respect of securities constituted under third-country law, this could lead to a **competitive disadvantage for ICSDs**.

3.8.4. Specific aspects of the framework which may benefit from further clarification/revision

3.8.4.1. Recognition for the provision of settlement services

There is a split between stakeholders on whether recognition of third-country CSDs should be required also for the provision of settlement services. On the one hand, there are stakeholders, including CSDs and their association as well as a competent authority, who consider the introduction of such a requirement as ***rather relevant or relevant***. The need to ensure consistency between the procedure for CSDs to obtain a passport according to Article 23(2) of CSDR and for third-country CSDs to be recognised according to Article 25 is particularly underlined to ensure a level playing field between EU and third-country CSDs. On the other hand, certain competent authorities and some CSDs were ***neutral***, with some of them noting that this change is not expected to be substantive. Only two stakeholders, including a third-country CSD and a competent authority, consider this issue as ***irrelevant***.

3.8.4.2. Clarification of the term "financial instruments constituted under the law of an EU Member State"

The majority of the stakeholders that responded to this question, including competent authorities, CSDs and their association, considered it ***rather relevant or relevant*** **to clarify what is meant by "financial instruments constituted under the law of an EU Member State"**. The justification made by some is the need to ensure that EU competent authorities and ESMA have transparency on EU established issuers using the core services of a third-country CSD, as EU issuers using a third-country CSD will likely use the local law of that third country. It was noted by respondents that this requires a broader reflection, also in line with possible amendments to CSDR requirements on the passport for the provision of cross-border services in the Union.

Certain stakeholders, including certain CSDs and a competent authority were ***neutral t***o this option. Only two considered it irrelevant.

3.8.4.3. Recognition of third-country CSDs based on their systemic importance for the Union or one or more of its Member States

The majority, including CSDs and their association, competent authorities, and a third-country CSD, considered that the introduction of a requirement whereby third-country CSDs are recognised based on their systemic importance for the Union or one or more of it Member States is ***irrelevant*** or ***rather irrelevant***. A competent authority noted that, considering the nature of CSD services and the close links with national corporate law, granting ESMA the supervision of systemically important third-country CSDs could cause issues with ESMA also interpreting the application of Member State laws.

On the other hand, some stakeholders, including CSDs and a competent authority, were ***neutral*** to this possibility noting however that an assessment similar to the one made for third-country CCPs does not seem appropriate as CSDs have a much stronger domestic focus. Only one competent authority, considered that the introduction of such a requirement is ***relevant***.

3.8.4.4. Enhancement of ESMA's supervisory tools

There was a split between stakeholders regarding the potential enhancement of ESMA's supervisory tools over third-country CSDs: some CSDs and their association as well as certain competent authorities, considered it as ***relevant or rather relevant***. Amongst those, some argued that while ESMA already has several tools to supervise third-country CSDs in the EU, namely the recognition process in Article 25 of CSDR, transparency should be treated as a priority and ensured at all times. In this regard, ESMA may also need to notify NCAs of the relevant Member States. A competent authority considered that enhancing ESMA's supervisory tools over third-country CSDs would be consistent with the increased role of ESMA regarding third-country supervised entities (e.g. in supervision of third-country CCPs).

Other stakeholders, including certain competent authorities and some CSDs, were ***neutral***. Amongst them, certain noted that further supervisory tools would be warranted where cooperation with the third-county supervisor of the third-country CSD is not satisfactory. This, however, they argued would rather speak against granting equivalence in the first place or suggest a revocation of recognition once granted.

3.9. Other issues raised in the targeted consultation

In total 37 respondents provided a reply when asked about other areas to be potentially considered in the CSDR review, and several issues appeared in numerous replies:

- Several public authorities pointed out that although Article 22(3) CSDR requires competent authorities to establish a **resolution plan for CSDs** no EU harmonised framework for resolution exists. In addition, they noted that many Member States do not have a national law that would cover the resolution of a CSD. A public authority indicated that only the few CSDs that have a limited banking license can avail

themselves of the resolution procedure described in the Bank Recovery and Resolution Directive (BRRD)[17]. According to public authorities, this can be problematic not only in case of resolution, but also for the supervision of CSDs offering cross-border services. A public authority believed it would be helpful to clarify in Article 22(3) CSDR that in the absence of a designated resolution authority (EU or national), the CSD should draft its own resolution plan. Other public authorities suggested that the Commission reflects (outside the context of the review) if a resolution plan is needed and potentially propose a resolution regime or issue guidance to competent national authorities.

- A bank pointed to a potential **liability mismatch** between CSDs and intermediaries in case of settlement fails. Currently the burden is carried by intermediaries without any standards of care or liability imposed by CSDR on the CSDs. This stakeholder argued that CSDs should be held to a high level of responsibility for the services they provide, similarly to other systemically important market infrastructures.

- **Potential conflict between CSDR and other sectorial legislation**. A group of stakeholders representing central banks, CSDs, their participants and the banking sector pointed to the need to harmonise certain aspects of national corporate and securities laws at EU level with corporate governance being regulated nationally. A bank referred to the gaps in coverage between CSDR and the Shareholder Rights Directive[18], i.e. the determination of base positions that drive allocation of rights. A group of CSDs believed that the interaction between CSDR and AIFMD[19]/ UCITS[20] and CRD[21]/ CRR[22] respectively should also be acknowledged. In the former case, they believed that CSDR should indicate that depository protection rules are covered by the Regulation. In the latter case, the Regulation should acknowledge existence of groups combining a CSD and a banking-licensed entity. A few stakeholders opposed including share ownership regimes and **proprietary aspects of securities held in CSD accounts** in the scope of the review (Recital 57). They believed it is an issue of national legislation. Furthermore, according to them the lack of a harmonised EU framework in this field has not hindered the operation of a harmonised CSD market.

- Several stakeholders **supported further harmonisation in tax-related matters, insolvency laws, and securities laws**.

[17] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms

[18] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement

[19] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMD)

[20] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

[21] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD)

[22] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (CRR)

- In light of the fact that T2S has allowed CSDs to outsource settlement services to the ECB without the possibility to manage the associated risk flowing from the outsourcing of these services, several stakeholders asked whether waiving of **outsourcing requirements** (Article 30) is not excessive. They suggested reconsidering whether some requirements should be applicable to this particular kind of outsourcing arrangements if this could enhance the risk management of the CSDs.

- The review of the provision of cross-border services should be expanded to include **links between CSDs**. Several respondents claimed that the establishment of such links is not equal to the provision of cross-border services and should not be subject to similar requirements. Furthermore, they argued that **a simplification of the CSD links framework would incentivise cross-border use of CSD services**. In addition, as CSD links are fundamental to cross-border transactions, one public authority suggested that a deadline should be added for operational implementation following an approved access request.

- According to a national competent authority a proportionality check on all CSDR provisions should be part of the review process, listing the annual review and evaluation process, discriminatory use of open communications standards (Article 35) or scope of outsourcing as particularly problematic.

- Lastly, other issues mentioned by individual stakeholders were cash compensation in fixed income contracts and the possibility for NCAs to intervene if CSD charges to clients are excessive.

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