III

(Preparatory acts)

EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 28 July 2022

on a proposal for a regulation amending the Central Securities Depositories Regulation

(CON/2022/25)

(2022/C 367/03)

Introduction and legal basis

On 13 April 2022 the European Central Bank (ECB) received a request from the Council for an opinion on a proposal for a regulation amending Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories ([1]) (hereinafter the 'proposed regulation').

The ECB's competence to deliver an opinion on the proposed regulation is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union (TFEU), as the proposed regulation touches upon (1) the basic task of the European System of Central Banks (ESCB) to promote the smooth operation of payment systems pursuant to Article 127(2), fourth indent, TFEU, and Article 3.1 of the Statute of the ESCB and the ECB (hereinafter the 'Statute of the ESCB'), and (2) the ESCB's contribution to the smooth conduct of policies pursued by the competent authorities relating to the stability of the financial system pursuant to Article 127(5) TFEU and Article 3.3 of the Statute of the ESCB. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

General observations

The ECB welcomes the proposed regulation, which supports both the priorities of the Union in the areas of capital markets and post-trading, and one of the core actions in the Commission's 2020 Capital Markets Union (CMU) Action Plan to develop cross-border settlement services. It does this, inter alia, by simplifying the passporting process under Regulation (EU) No 909/2014 of the European Parliament and of the Council ([2]) (hereinafter the 'Central Securities Depositories Regulation', or the 'CSDR') and enhancing cooperation among competent and relevant authorities. The ECB strongly supports the general aim of further facilitating capital markets integration by reducing barriers to the cross-border provision of settlement services. The proposed regulation is also broadly aligned with policies pursued internationally in the aftermath of the global financial crisis that emerged in 2008-2009, aimed at reinforcing the resilience and effectiveness of core, systemically important financial market infrastructures – including securities settlement systems – as a precondition for sound and robust capital markets, and the promotion of financial stability ([3]).

([1]) COM(2022) 120 final.

([2]) 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 and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (OJ L 257, 28.8.2014, p.1).

([3]) The reference is to the seminal work of the Financial Stability Board entitled 'Reducing the moral hazard posed by systemically important financial institutions - FSB Recommendations and Time Lines', 20 October 2010, available on the Financial Stability Board's website at www.fsb.org

Specific observations

1. *Settlement discipline regime*

1.1. The ECB welcomes the Union legislator's objective to establish a more targeted scope for the CSDR's settlement discipline regime by addressing market behaviours that lead to settlement inefficiencies, but without automatically penalising every individual settlement fail regardless of the context and parties involved. The scope and functioning of the settlement discipline regime should be based on the principle of proportionality. This requires, inter alia, differentiating between, on the one hand, settlement fails that produce adverse financial effects for the non-failing party to a financial transaction, and, on the other hand, those that either produce no adverse financial effects at all or merely affect the financial interests of the failing party. The inclusion of these latter settlement fails within the scope of the settlement discipline regime would be inconsistent with the regime's rationale. Therefore, the review of the settlement discipline regime should take as its starting point the aim of sanctioning only those settlement fails that result in adverse financial effects for the counterparty of the failing party.

1.2. In the same vein, the ECB welcomes the proposed exclusions from the settlement discipline regime of both settlement fails caused by factors not attributable to the participants to the transaction, and settlement fails occurring in the context of transactions that do not involve 'two trading parties'. However, the ECB invites the Union legislator to consider clarifying the scope of the second of these two proposed exclusions, which lends itself to different interpretations. The ECB understands this proposed exclusion as encompassing free-of-payment (FOP) securities transfers to securities accounts at central securities depositories (CSDs) in the context of the (de)mobilisation of collateral, whether those transfers are between private parties or between members of the ESCB and their counterparties. The ECB would welcome an explicit clarification to this effect in the proposed regulation. In this respect, further clarifications on the scope of the second proposed exclusion should be provided in the delegated acts of the Commission, to specify the transactions that are not considered as involving two trading parties. CSDs might not at present be equipped to identify settlement instructions that are to be excluded from the scope of the settlement discipline regime under the proposed regulation. To facilitate such identification, the delegated acts of the Commission could helpfully include definitions that enable the envisaged exclusions to be concretely identified, thereby assisting CSDs in reaching an automated process. The ECB stands ready to support the Union legislator in the elaboration of these clarifications, and notes that the Commission draft delegated acts qualify as 'proposed Union acts' for the purposes of Articles 127(4) and 282(5) of the Treaty, which provides that the ECB must be consulted on any draft Union acts falling within its fields of competence ([4]).

1.3. In addition, such Commission delegated acts that specify the transactions that are not to be considered as involving two trading parties should contemplate sufficient lead time for CSDs and financial market participants to adjust their systems. For instance, as regards TARGET2-Securities (T2S), if certain transactions are to be excluded from the scope of the settlement discipline regime at CSD level, a dialogue with the market would be advisable to help identify potential implementation issues and possible solutions. Where the relevant Commission delegated acts entail material changes to the design of T2S, the implementation of such changes would require significant time. Hence, the ECB recommends that the period of 24 months which the proposed regulation contemplates between the adoption of the revised CSDR and the entry into force of the amended scope of the settlement discipline regime ([5]) should only start from the adoption of the relevant Commission delegated acts.

1.4. The existence of regulation-driven mandatory buy-ins is a significant interference in the execution of securities transactions and the functioning of securities markets. Because of the implications that the deployment by the European Commission of mandatory buy-ins may have (including with respect to the potential non-availability of a buy-in agent), it would be preferable to discard the possibility of mandatory buy-ins altogether. Any later changes in this regard should be left to the subsequent consideration of the Union legislator.

1.5. If, nevertheless, the Union legislator decides to retain the proposed provisions regarding the implementing act by the European Commission for the deployment of the mandatory buy-in mechanism, the ECB would like to note the following points. First, the ECB welcomes the proposed regulation's revisions to the mandatory buy-in mechanism. The application, through an implementing act, of conditions for activating a mandatory buy-in mechanism in respect of certain financial instruments or categories of transactions should be weighed against the impact of mandatory buy-ins on the functioning of securities markets. Furthermore, such an implementing act should take into account the

([4]) See paragraph 4.1 of Opinion CON/2017/39. All ECB Opinions are published on EUR-Lex.
([5]) See Article 2 of the proposed regulation.

potential effects of the mandatory buy-in mechanism on the financial stability of the Union and on settlement efficiency in the Union ([6]) – both of which are matters that should be considered as falling within the ECB's fields of advisory competence – and such an implementing act should therefore be submitted for ECB consultation prior to its adoption. It should also afford market participants sufficient time for implementation so that they can achieve operational readiness. Regarding the requirements related to the modalities applicable to the execution of buy-ins, it is important that the costs of execution should not be disproportionate to the value exchanged in the underlying transaction. Moreover, in accordance with the proportionality principle, some measure of flexibility should be given to market participants to whom the buy-in would apply in a given case. Consideration should be given to an approach whereby, instead of legislation prescribing the exact method of executing buy-ins, market participants are required to contractually agree on such details between themselves. In addition, an option could be given to the non-failing party to decide whether or not the buy-in process is to be triggered. This flexibility would enable a non-failing party to avoid the disproportionate burden of the implementation of complex operational, technical and legal changes necessary for the use of buy-ins.

1.6. Finally, the ECB invites the Union legislator to consider excluding securities financing transactions from the scope of any mandatory buy-ins. A securities financing transaction does not create an outright open position between the trading parties such as to justify a buy-in against the failing party. Accordingly, the application of mandatory buy-ins in the context of securities financing transactions would not be proportionate to the intention of the legislator to reduce, through mandatory buy-ins, the number of settlement fails.

2. *Cooperation between competent authorities and relevant authorities: review and evaluation*

2.1. The ECB welcomes the enhancement under the proposed regulation of the role of the relevant authorities in the authorisation of CSDs to provide core services and banking-type ancillary services, as well as in the conduct of the regular review and evaluation of CSDs, that duly acknowledges the legitimate interest that such authorities have in the smooth functioning of the relevant infrastructures. By the same token, the ECB welcomes the balanced approach of the proposed regulation as regards the frequency of conducting the review and evaluation of core CSD services, as well as the longer timeframe within which the relevant authorities may provide a reasoned opinion on the authorisation of CSDs to provide banking-type ancillary services. To ensure consistency, there would be merit in aligning the proposed minimum frequency with which the competent authorities review and evaluate compliance with the CSDR of banking-type ancillary services with the frequency of the review and evaluation of core CSD services.

2.2. As regards the review and evaluation of core CSD services, the proposed regulation envisages that a competent authority consults the relevant authorities. However, no corresponding procedure is contemplated as regards the review and evaluation of banking-type ancillary services. To address this inconsistency, the ECB recommends introducing in the proposed regulation a corresponding consultation procedure for the review and evaluation of banking-type ancillary services.

2.3. For those ESCB members that act as a relevant authority, such a consultation procedure would facilitate the performance of the ESCB's task to ensure efficient and sound clearing systems within the Union. Moreover, in the conduct of their day-to-day activities, CSDs authorised as providers of banking-type ancillary services rely heavily on central bank services ([7]), further warranting the involvement of central banks. The safety and efficiency of cash settlements in commercial bank money are particularly relevant for central banks of issue, as inadequate management of credit and liquidity risks by the CSDs providing banking type-ancillary services could affect the smooth functioning of money markets.

([6]) See Article 1(2)(b) of the proposed regulation.

([7]) For example, CSDs deposit their long cash balances in accounts with central banks, organise the funding and defunding of their settlement activity through transfers via accounts with payment systems operated by central banks, and have recourse to central bank credit facilities as a key source of qualifying liquid resources.

2.4. In their role as overseers of clearing and payments systems, central banks have extensive expertise in the field of cash settlement in central bank and commercial bank money (including associated banking-type ancillary services), in particular from the perspective of the management of financial risks. In conducting their oversight activities, central banks apply a framework which – in line with global standards – reflects a systemic perspective. Therefore, their involvement as relevant authorities under the CSDR in the regular review and evaluation of banking-type ancillary services is advisable.

3. *Cooperation among competent authorities and relevant authorities: establishment of colleges*

3.1. The ECB welcomes the introduction of colleges of supervisors in order to enhance supervisory convergence and facilitate information exchanges among involved authorities ([8]). Nevertheless, the structure of the passporting colleges could benefit from further adjustments to ensure, on the one hand, that various types of cross-border activity are covered and, on the other hand, that the cooperation within the college is efficient and does not create a burden where participation in multiple colleges is required. The passporting activity does not include all CSD services with a cross-border dimension. Therefore, the ECB proposes to widen the scope of the passporting colleges' mandate to cover other types of cross-border activities, including settlement in relevant foreign currencies and the operation of interoperable links, except for interoperable links of CSDs that outsource some of their services (related to those interoperable links) to a public entity as referred to in Article 19(5) of the CSDR ([9]). The ECB also proposes to rename the passporting colleges as cross-border activity colleges. Moreover, participation in the colleges is crucial for the authorities of Member States where the activities of a CSD are important to their markets. However, it might be less relevant for the authorities of Member States where the activity of a CSD is limited, and should not be mandatory.

3.2. As regards group colleges, the ECB supports their establishment and, in particular, the optionality introduced in the proposed regulation to merge colleges into one single college. In addition, further flexibility could be introduced by allowing the home competent authority to invite the competent and relevant authorities from countries that are not Member States as observers for both passporting and/or group colleges.

4. *Banking-type ancillary services*

4.1. The proposed regulation includes amendments to the CSDR allowing the settlement of the cash payments in a securities settlement system operated by a CSD through another CSD that is authorised to provide banking-type ancillary services. Together with the proposed increase of the threshold for settlement via designated credit institutions, these amendments would facilitate settlement in foreign currencies, and promote cross-border settlement within the Union. At the same time, the potential recourse to FOP settlement where cash and securities transfers are not conditional on each other - and therefore increase settlement risk – would be limited.

4.2. Nevertheless, the provision of banking-type ancillary services by CSDs authorised to provide them (hereinafter the 'banking CSDs') to other CSDs (hereinafter the 'user CSDs') would have implications for the financial risk profile of the banking CSDs and for the level playing field for CSDs and for participants in the securities settlement systems that the CSDs operate, as well as in relation to conflicts of interest; all of these implications would need to be further addressed by the Union legislator. Therefore, the proposed regulation could be amended to include the possibility of developing regulatory technical standards to address the implications described in paragraphs 4.3 to 4.8 below of the provision of banking-type ancillary services by banking CSDs to user CSDs.

4.3. Article 40 of the CSDR requires CSDs to settle the cash leg of securities transactions processed in their securities settlement systems through accounts held with a central bank specifically for transactions denominated in the currency of the country where the settlement takes place, where practical and available. The amendments envisaged by the proposed regulation should neither lead to an unintended shift from settlement in central bank money to settlement in commercial bank money, nor disincentivise the efforts of CSDs to achieve settlement in central bank

([8]) See Article 1(9) of the proposed regulation.
([9]) Article 19(5) of the CSDR provides for special treatment of such interoperable links.

money. In this respect, it should be noted that currently, subject to one exception, all national central banks of the Member States allow access to central bank money settlement for non-domestic Union CSDs and their participants. However, settlement in central bank money for non-Union currencies may be difficult to achieve.

4.4. While the objective of the amendments envisaged by the proposed regulation is to facilitate settlement in foreign currencies ([10]), they also open the possibility to the banking CSDs to offer, without restriction, any banking-type ancillary service to user CSDs. The scope of services to be offered by banking CSDs to user CSDs should be limited to services which are provided for the purposes of settlement in foreign currencies. Such a limitation would prevent the banking CSDs from engaging in a broad range of activities and taking excessive risks. In addition, such a limitation would also discourage user CSDs from seeking the services of banking CSDs where, for EU currencies, cash settlement in central bank money would also be available.

4.5. The provision by CSDs of banking-type ancillary services to user CSDs would entail additional exposures. In particular, the services that a banking CSD could provide to user CSDs would generate financial risks for the CSDs (e. g. investment, credit and/or liquidity risks) ([11]). The magnitude of these risks depends on the scope of services availed of by the user CSDs and the value of the activity of such CSDs on the accounts with the banking CSDs. Furthermore, if settlement in foreign currencies is concentrated in one or two banking CSDs within the Union, this may lead to contagion risk. The prudential requirements laid down in the CSDR establish a sound prudential framework and address risks in relation to banking-type ancillary services. However, setting up measures to control risks when a banking CSD provides services to user CSDs may prove to be complex in a context where the participants of the user CSD, as well as the activity generating these risks and the evolution of those risks, are not under the direct control of that banking CSD. Therefore, the Union legislator may need to contemplate introducing a requirement for banking CSDs to develop a framework that elaborates on how risks stemming from the activity of the user CSDs can be contained. Overall, the ECB favours a balanced approach aimed at ensuring that the potential expansion of this activity by banking CSDs (and, therefore, also the increased risk exposures, as well as the concentration and potential contagion risk stemming from this expansion) is commensurate with the intended objective of facilitating settlement in foreign currencies by user CSDs, and does not put at risk the financial soundness of banking CSDs.

4.6. Under the proposed regulation, banking CSDs could provide cash clearing and settlement services not only to their participants but also to participants of user CSDs. This could give rise to potential conflicts of interest whereby a banking CSD takes decisions or puts in place policies that favour its own participants or CSDs within the same group. This could be particularly relevant in a crisis situation, for example when unforeseen liquidity shortfalls or uncovered credit losses emerge. Therefore, the regulatory framework should include a requirement for CSDs to have in place clear rules and procedures addressing potential conflicts of interest and mitigating the risk of discriminatory treatment towards any user CSDs and their participants.

4.7. The provision by banking CSDs of banking-type ancillary services to user CSDs would impact the risk profile of those banking CSDs and may also entail additional costs and operational complexity. Not all banking CSDs may be willing or able to increase their exposures to credit and liquidity risks and to allocate resources in order to allow for an expansion of the settlement activity in foreign currencies of user CSDs. The ECB understands that the provision of banking-type ancillary services to user CSDs remains a business decision of each banking CSD (in distinction to the establishment of links and open access to other CSDs, which should be ensured as a matter of course ([12])).

([10]) See recital 25 of the proposed regulation.

([11]) For instance, intraday/overnight deposits of user CSDs' participants in accounts with a banking CSD need to be reinvested, which gives rise to risk exposures. Extension of intraday credit could result in credit and liquidity risk in case one or more participants of non-banking CSDs do not reimburse the amounts when due. Credit lines provided in several currencies by the banking CSD would also represent a source of market, credit and liquidity risks. Payments of coupons or redemptions of securities issued via/held through the user CSD also generate intraday or overnight risk exposures for the banking CSD.

([12]) See Chapter III, Section 2 of the CSDR on access between CSDs.

4.8. Moreover, in order to foster transparency in relation to the terms and conditions for the provision of banking-type ancillary services, any future regulatory technical standards should set out the disclosure requirements to which the banking CSDs should adhere as regards the minimum range of services offered, as well as the terms and conditions of such services and the costs and risks associated with them. This would avoid the possibility that CSDs within the same group as a banking CSD benefit from preferential treatment and, therefore, gain a competitive advantage over other user CSDs as regards settlement services in foreign currencies.

5. *Netting*

5.1. The ECB welcomes the introduction by the proposed regulation of a requirement for banking CSDs to adequately monitor and manage any risks stemming from netting arrangements in relation to the cash leg of their applied settlement model ([13]). The ECB understands there are CSDs established in the Union that operate securities settlement systems in which cash and/or securities in relation to securities transactions are settled on a net basis. Such CSDs are not currently subject to specific requirements addressing the risks stemming from their netting arrangements.

5.2. The risks associated with netting arrangements and the requirements that are intended to address those risks are reflected in several principles of the Principles for financial market infrastructures (PFMIs) issued by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) ([14]). It is noted that the requirement envisaged by the proposed regulation as referred to in paragraph 5.1 applies only to banking CSDs. However, it should apply to all CSDs operating securities settlement systems that use netting arrangements, irrespective of whether those CSDs provide banking-type ancillary services or not. Given the technical nature of the additional requirement applicable to such systems under the proposed regulation, this requirement could be further detailed in regulatory technical standards, to which the ECB stands ready to contribute.

6. *Default*

6.1. It is beneficial to broaden the scope of the definition of default in the CSDR ([15]), which is currently confined to the opening of insolvency proceedings against a participant in a securities settlement system operated by a CSD (hereinafter the 'CSD participant'). To that end, the definition could be aligned with the definition set out in the PFMIs ([16]), ([17]), which refers to events specified in the CSD's internal rules as constituting a default, including events related to a failure to complete a transfer of assets in accordance with the terms and rules of the concerned system.

6.2. It is of crucial importance that when a CSD participant is not able to fulfil its obligations when they fall due, for whatever reason, the relevant CSD can promptly take action to contain losses and limit liquidity pressures. Therefore, the Union legislator may wish to reflect on a clarification to the effect that a CSD has the possibility to determine additional events that constitute a default by a CSD participant, where the default management rules and procedures referred to in the CSDR are not sufficient to address material events that may occur in a system.

Where the ECB recommends that the proposed regulation is amended, specific drafting proposals are set out in a separate technical working document accompanied by an explanatory text to this effect. The technical working document is available in English on EUR-Lex.

([13]) See Article 1(19)(a)(iii) of the proposed regulation.
([14]) See CPSS-IOSCO Principles for financial market infrastructures available on the BIS website at www.bis.org.
([15]) See Article 2(26) of the CSDR.
([16]) According to Annex H of the PFMIs: 'default – An event stipulated in an agreement as constituting a default. Generally, such events relate to a failure to complete a transfer of funds or securities in accordance with the terms and rules of the system in question.'
([17]) In this context, it is noted that recital 6 of the CSDR underlines the importance of ensuring consistency between the CSDR-related legislation and international standards.

Done at Frankfurt am Main, 28 July 2022.

The President of the ECB
Christine LAGARDE