EUROCLEAR S.A./N.V.
1 BOULEVARD DU ROI ALBERT II
B-1210 BRUSSELS, BELGIUM

March 1, 2011

Euroclear response to the Commission's consultation on CSDs and harmonisation of certain aspects of securities settlement in the EU

This response is provided on behalf of the Euroclear group of companies ("Euroclear"). Euroclear comprises the international central securities depository ("ICSD") Euroclear Bank ("EB"), based in Brussels, as well as the national central securities depositories ("CSDs") Euroclear Belgium ("EBe"), Euroclear France ("EF"), Euroclear Nederland ("ENL"), Euroclear UK & Ireland Limited ("EUI"), Euroclear Finland ("EFi"), and Euroclear Sweden ("ES"). It also includes Xtrakter, a provider of trade matching and transaction reporting services based in the UK.

Euroclear is registered on the European Commission's register of interest representatives (ID number 88290282308-75).

INTRODUCTION

Euroclear supports the initiative for a CSD Legislation ("Legislation") at EU level. We are confident that a coherent and consistent European regulatory framework based on a harmonised authorisation regime, uniform prudential requirements and conduct of business rules will promote the continued safety and soundness of CSDs. This will contribute, in the long term, to support market harmonisation across the EU. This is particularly important in an environment where all trading and post-trading market infrastructures continue to undergo many challenges, including changes at trading venues and CCPs following the revisions to MiFID and the forthcoming EMIR, adaptations required under the Securities Law Directive (SLD), harmonisation of market practices (driven in part by T2S), increased competition between CSDs and continued calls for CSD consolidation.

We welcome the Commission's consultation and appreciate the openness of the Commission to gather input from the industry, market players and authorities. We are pleased with the Commission's decision to dedicate separate attention and time to the legislation of CSDs rather than integrating these market infrastructures in the frame of EMIR which is subject to a stretched timetable and a different set of drivers.

The Legislation should respect the role that CSDs play in the market. These institutions have been established to increase the efficiency and to reduce the risks in financial markets, by means of standardisation, harmonisation, commoditisation, and by centralising the provision of certain services.

This response is divided into the following sections

1. Key points
2. General points
3. Consultation Answers

Any questions on this response can be directed to:

Paul Symons, Head of Public Affairs (paul.symons@euroclear.com)

Ilse Peeters, Director Public Affairs (ilse.peeters@euroclear.com)

SECTION 1 KEY POINTS

1. We understand and generally support (subject to the comments made in this paper) the Commission's wish to proceed to a harmonised EU regulatory framework for CSDs. However, we note that these market infrastructures have shown great robustness during the financial crisis and that no regulatory failures have been identified. The regulatory gaps in EU CSDs are limited and are mostly related to the difficulty (or even impossibility) for CSDs to compete on a number of aspects due to regulatory barriers. These are described below in Section 2.

2. We would urge the Commission to reduce the level of detail in the Legislation and to leave it up to ESMA to issue implementing standards for the various topics (working with the ESCB). These standards should build on the ESCB/CESR recommendations, or potentially on the revised CPSS/IOSCO recommendations.

International Securities Depositaries (ICSDs) – Euroclear Bank

3. We believe that the ICSDs, EB and Clearstream Banking Luxembourg (CBL), could be covered by the new Legislation, if it allows these entities to maintain their strengths. It is well-known that these specific EU market infrastructures successfully provide global financial services most notably for international debt securities (representing a total outstanding amount of almost €9 trillion). However, the particular services of the ICSDs (including their tightly regulated commercial bank money settlement services in multi-currencies) need to be taken into account in the drafting of the Legislation.

4. To cater for the ICSD model within a single CSD licence, CSDs should be able to apply for a separate banking licence. To alleviate any concerns on the related banking risks, it could be envisaged that - when a CSD combines a banking licence with a CSD licence - the banking services would only be offered in relation to the CSD's core and ancillary services ("limited purpose banking"). CSDs with a banking licence would be subject to standard banking legislation although the Legislation could include additional requirements such as those of the ESCB/CESR recommendations (e.g. on collateralisation of customer exposures, liquidity requirements, etc).

Functional approach to definitions

5. We note the Commission's intention to apply a functional approach, and urge the Commission to develop objective criteria to decide if, and how, the Legislation would apply to entities that are not CSDs, but that are nevertheless performing CSD services. We should avoid a situation – as experienced with MiFID for trading activity – whereby certain CSD activities could take place outside the scope of the Legislation leading to a growing part of this activity being performed by entities that are not in the scope of the Legislation, or even explicitly excluded by it. As with MiFID, this may necessitate the review of the Legislation after a number of years.

6. We believe that the core services of a CSD should be defined in a way which allows all current CSD-models to be captured, but which does not artificially capture other regulated entities (custodian banks etc). We are of the view that there are three services that can be seen as the better common denominator of services performed by CSDs in the EU: *notary*, *safekeeping* (including securities account maintenance and provision) and *settlement*. These services should be defined in a broad way which should allow national regulators to designate the entities that perform these functions in their respective market. To deal with consistency concerns, it could be envisaged to give a role to ESMA not only to register EU CSDs but also to validate and, where necessary, challenge the decision of the national regulators in their identification of CSD services.

7. Apart from the three "core" functions, we believe there are many other services that CSDs perform which generally contribute to enhancing the safety, efficiency and transparency of securities markets. While these services could be defined as "ancillary" services at EU level, they are - at the level of an individual Member State - often considered as "core" services. We would prefer to define "ancillary" services by a set of criteria rather than trying to exhaustively list them in the Legislation. We emphasise however, that the distinction between "core" and "ancillary" is artificial as CSDs will offer these services in a technically or operationally integrated way in order to optimise efficiencies.

Prudential and conduct of business requirements

8. We are concerned by the level of detail included in some parts of the consultation, specifically in the area of prudential and conduct of business requirements. It is our view that the level 1 Legislation would only set broad regulatory principles and that the detailed standards will be set by ESMA and ESCB, which could then build – where applicable - on the existing ESCB/CESR recommendations, or potentially on the forthcoming revised CPSS/IOSCO recommendations.

9. Moreover, the consultation document mixes prudential requirements for CSDs and their conduct of business rules. For example, the document starts from the assumption that CSDs incur settlement risk from which the CSD should be protected. This is not correct as CSDs will never incur settlement risk (unless rarely when they enter into non-DVP transactions for their own account). CSDs however, should ensure that their securities settlement system operates in a way that removes settlement risk of their customers to a maximum extent, e.g. by ensuring DVP settlement and intraday finality.

Authorisation and supervision

10. We are concerned by the heavy supervisory structure that is proposed for CSDs which in part appears to have been imported from EMIR. We would like to stress that the risk profile of a CSD is very different from that of a CCP, e.g.

- Taking risks is the most important function of a CCP, which concentrates and mutualises risk within one institution. Most CSDs incur only operational risk, not credit or liquidity risk. But even CSDs that incur banking risks (such as the ICSDs) maintain a very low risk profile, as the exposures that they incur are limited, tend to be very short-term (mostly intraday) and are highly collateralised;
- As CSD links mostly take the form of opening of a securities account with another CSD, the related risk is far less significant than in a situation of CCP interoperability. The risk associated with a link will seldom be of systemic relevance;
- Many CSD links exist and have been operating safely and efficiently for many years. The models of CSD links have been tested, which is different from CCPs where no links exist (and only very few models of interoperability). Moreover, many of these CSD links are approved and used by national central banks in the context of their monetary and credit operations.

11. Many CSDs today already have an element of cross-border service provision: they service issuers from foreign markets, have foreign customers, have established CSD links, and have become part of larger groups of CSDs and Stock Exchanges etc. We believe that the current regulatory and supervisory structure already deals well with these elements of "externality".

12. We request therefore, that the Commission proposes an authorisation and supervision structure that is commensurate with the risk that is inherent in the CSD business, and that does not make their regulatory environment overly burdensome. Should CSDs and CSD links become subject to an overly complex regulatory structure, this would put under pressure their role as providers of market infrastructure services that are designed to take risks out of the post-trading activities. This would not only impact the CSDs themselves, but also their customers. The result could be that business might move to entities that are not specifically regulated for CSD-type services and face a lesser regulatory burden on these aspects. Overall risks in the market could therefore increase rather than decrease.

13. We understand that this increasing cross-border nature of CSD services requires that supervisors have a sufficiently robust framework for sharing information on this cross-border business. The development of adequate information sharing provisions amongst supervisors should not increase the regulatory burden on CSDs.

Relation of Legislation with MiFID and EMIR

14. The Legislation will complete the range of legislative instruments covering securities trading and post-trading, with MiFID concentrating on trading venues and EMIR on CCPs and Trade Repositories. We wish to stress that there should be consistency between these instruments, specifically with regard to how they integrate the main elements of the Code of Conduct: price transparency, access and interoperability, and service unbundling and accounting separation. The proposed EMIR, MiFID (current Directive and ongoing consultation) and consultation on the Legislation demonstrate that the Commission is considering applying the main elements of the

Code to CSDs only. If the Commission believes that these elements should not find their way into the MiFID review or in EMIR, they should not be included in the CSD Legislation either. Otherwise, this could lead to level playing field concerns, specifically for CSDs that do not form part of a group that integrates trading, clearing and settlement vertically.

We believe the Commission should undertake a holistic review to ensure that all layers in the trading and post-trading industry are treated equally and that no part is left uncovered.

Range of financial instruments

15. We assume that the Legislation will apply across the whole range of financial instruments (debt and equity securities, funds, certificates of deposit, bank loans, etc), i.e. it should allow (but not oblige) CSDs to (continue) offering services across instrument types.

Target2-Securities (T2S)

16. We note that the Commission proposes certain exemptions to regulatory outsourcing requirements when a CSD outsources to the public sector. This exemption is unique for CSDs and is not replicated in EMIR nor is it mentioned in the MiFID consultations. We believe that any outsourcing must be treated according to the same regulatory rules. We would like to understand the rationale for introducing a precedent in relation to one specific development (T2S) and for all public entities.

    The result of exempting CSDs from certain outsourcing requirements is that national regulators will no longer have a role to play in the supervision of the related outsourcing arrangements. The key question therefore, is if Member States will be comfortable giving up certain regulatory powers, and which authority will bear the responsibility in case of problems with the outsourcing arrangement. We also would like to understand what would be the impact of such provisions on CSD liabilities, and if and how these liabilities would be covered by CSDs or market participants through capital requirements or insurance.

Harmonisation of settlement discipline and settlement cycles

17. We appreciate that the Commission would like to introduce proposals to harmonise certain aspects of securities settlement in the EU through the Legislation. However, this Legislation may not be the most appropriate legal vehicle, as the rules on settlement discipline and settlement cycles are not (only) relevant for CSDs, but to all relevant market players such as trading venues, CCPs, custodian banks.

18. The Legislation should set out only the general principles/objectives of harmonisation of settlement discipline and settlement cycles. We believe the Legislation should not contain detailed provisions. These should be left to market players, potentially together with ESMA, to jointly

assess market practices and harmonisation solutions. With regard to settlement cycles, most CSDs today can already deal with shorter settlement cycles (even down to T+0).

SECTION 2 GENERAL POINTS

CSDs' role and current regulatory environment

CSDs are already well regulated entities that comply with specific local laws, with several sets of regulatory recommendations (ESCB/CESR), the ESCB user standards, and also in some cases with the Capital Requirements Directive (CRD) and MiFID. They are subject to close supervision by prudential regulators and are overseen by central banks. This is already a formidable regulatory burden with which to comply.

It is our view that regulatory gaps in the EU CSD area are limited and are related mostly to the difficulty (or even impossibility) for CSDs to compete in a number of areas due to regulatory barriers, e.g. because certain accesses have not been opened. The areas in which the Legislation can support the CSD industry to become more competitive and efficient are mainly the following:

- Ensure enforceable access rights to trading venues, CCPs and other CSDs;
- Licensing and passporting of CSD services that should allow EU CSDs not only to compete but also to consolidate (as it is generally accepted that the number of CSDs in the EU should diminish rather than increase);
- Revise current MiFID rules that we believe hinder the delivery of the full benefits of access and interoperability across trading, clearing and settlement (question 22)
- Provide a regulatory framework dealing with third country providers.

As the CSDs have shown no market failures and the regulatory gaps are limited, we believe there are no reasons for the Legislation to have a market (re)structuring effect. It should rather respect the specific characteristics of the current CSDs and the markets in which they operate. The definitions of CSD services need to be sufficiently broad and flexible so as to allow the different CSD business models to develop in a low risk environment.

ICSDs

EB and CBL are specific EU-based market infrastructures providing global services that have some characteristics that make them similar to a national CSD, notably in the role they play for international debt securities (representing a total outstanding amount of almost €9 trillion). However, these ICSDs are also different from a national CSD as they:

- are banks, set up with a full banking licence, although their banking services are offered in relation with core and ancillary CSD services only. They are compliant with the full set of

banking legislations, CRD as well as MiFID, and they comply with specific ESCB/CESR Recommendations on the management of credit and liquidity risk;

- provide settlement in commercial bank money only (in over 40 different currencies);
- provide short-term credit to customers (subject to credit analysis) to ease the settlement process across international markets, counterparties and currencies;
- compete also on an international scale from within the EU for the issuance of international debt securities (with DTCC, SIS and others providing similar services);
- are key market infrastructures supporting the repo markets;
- share a very sophisticated and proven model for CSD interoperability (the Bridge). This is currently the best (and only) example of CSD interoperability;
- have a more extended services offering, e.g. in collateral management services, corporate action processing, etc;
- provide services in securities from many markets and currencies, and
- have a extensive global client base.

Despite the above differences, we are of the view that EB could be subject to the new Legislation, provided that its rules allow EB to maintain its strengths. We therefore appreciate that the Commission has taken the specific situation of the ICSDs into account and welcome the Commission's proposal, e.g. on the possibility for CSDs to obtain (maintain) a banking licence, allowing them to provide banking services such as short-term credit provision and settlement in commercial bank money. We hope that the Commission's initial reflections will be included in the proposal for the Legislation.

We would like to guard against the potential unintended consequences of the new Legislation if this would require the business model of the ICSDs to be adapted. This could reduce their attractiveness and competitiveness in an international context whereby business may eventually leave the EU. We are ready to explore with the Commission how the proposal for authorisation and supervision of CSD would work specifically for the ICSDs.

SECTION 3 QUESTIONS

Part 1 – Appropriate regulatory framework for CSDs

I. Scope and definitions

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

We support a functional approach whereby reference is made to specific "CSD services" and whereby the same risk is subject to similar prudential or conduct of business requirements regardless of the nature of the provider of those services.

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

While the Commission clearly marks its preference for functional regulation, we fail to understand why this approach is immediately followed by a proposal to exempt some types of providers from the Legislation. We specifically regret that the Commission does not provide an objective rationale explaining why certain institutions would need to be exempt, and others not. In particular, we note that throughout the consultation emphasis is placed on maintaining the integrity of a securities issue, although (for example) entities such as registrars, which undertake this function in the UK and Ireland, are proposed to be exempted.

If the Commission considers that provision of CSD services gives rise to certain safety concerns, we would like to understand why the provision of these services – sometimes even by unregulated entities – would need to fall outside the scope of the Legislation. Such situation could lead to regulatory arbitrage.

We assume that some of the exemptions are proposed because the entities are already subject to a specific set of prudential requirements (e.g. transfer agents), because the prudential concerns are less relevant (e.g. CSDs operated by central banks), or because the CSD shares certain tasks with a financial firm (e.g. account operators in transparent systems).

We would urge the Commission to:

- Set objective criteria which determine which providers of CSD services could be exempt and the reasons why, and
- Perform a gap analysis between the prudential and conduct of business requirements that apply to such entities today and those that are required for CSDs. For example, to our knowledge, the only entities currently subject to a requirement to provide DVP settlement are CSDs; it is unclear why entities other than CSDs would not be required to offer DVP settlement so as to protect their customers from settlement risk. Along the same lines, while UK and Irish registrars are unregulated

in relation to their role of maintaining the integrity of the securities for which they act as registrar, we fail to understand why such role should be exempt.

Once objective criteria have been established and gaps identified, we believe that other/different entities than those that are listed in the Commission document could be candidates to be (partially) exempt from the Legislation. For example, Common Depositaries for their role in the issuance of international debt securities, Admitted Institutions in the Netherlands.

We also believe that the Commission should consider application of conduct of business requirements of the Legislation to entities that may be exempt from the Legislation for prudential requirements. For example, this could be the case for CSDs operated by central banks. We believe that these CSDs may nevertheless be required to comply with certain requirements on access, or on conduct of business rules such as e.g. DVP and finality.

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

We understand the Commission's approach to make a distinction between "core" and "ancillary" services. We agree that there are a number of functions that can be seen to be the "core" functions of CSDs as they represent a common denominator of services offered by EU CSDs. For markets or financial instruments for which these "core" services are not performed by current CSDs, a decision will need to be made on whether and how they should be included in the Legislation.

In addition to the defined "core services", CSDs will also perform a number of other services that are generally (but not always) related to these core functions. While these services can be seen as "ancillary" in an EU context, for some Member States, a number of these services may be seen as "core". For example, the Swedish Company and CSD Laws consider services provided to securities issuers such as registration and keeping lists of shareholders as "core" services for ES.

This is why any approach to the definition of CSD services should allow the Legislation to be sufficiently flexible to cater for the different models of CSDs that currently exists in the EU.

On the definition of "core" services, we have the following remarks:

Notary and central safekeeping function

We understand that the Commission wishes to distinguish between "notary" and "central safekeeping" on the basis of the fact that the first function includes a direct connection with the issuer and the second one does not. Those two functions should be sufficient to capture most CSD models. We nevertheless believe that it may be better to collapse both definitions into one broader definition as the distinction between "notary" and "central safekeeping" does not translate in specific authorisation, supervision, prudential or conduct of business requirements. In other words, having two separate definitions may create unwanted and unneeded confusion.

We would propose the following definition of "notary" services:

> *"Initial admission and/or establishment of certificated or dematerialised securities in book entry form"*

The definition refers to the initial representation and subsequent maintenance of securities in book-entry form through initial credit and subsequent credits or debits to securities accounts. It therefore refers to the "top tier of the book-entry system" but it does not include a reference to a direct link with the issuer which we believe is not required. Should there be a specific requirement related to the direct link with the issuer (e.g. the need to reconcile the integrity of the issue between the issuer account and the CSD customer accounts), the section of the Legislation that includes such requirement should simply state "where relevant" and will leave it to the relevant regulator to assess whether the requirement is relevant or not.

Safekeeping (including securities account provision or maintenance)

We believe that the function of safekeeping should be included as a core function of a CSD, although the inclusion of this function should not require commercial custodians and other intermediaries to be licensed as a CSD.

Safekeeping can be defined as:

> *"Maintenance and administration of securities on behalf of others, including through the provision or maintenance of securities accounts"*

Safekeeping is broader than the proposed definition of central safekeeping as it relates to a service provided for all securities, not only for securities for which the CSD performs the notary function. As a functional approach is followed, there is no need to distinguish between central and non-central safekeeping as the related prudential and conduct of business rules (e.g. on protection of customer assets) ought to be the same.

Our proposed definition of safekeeping also encompasses provision and maintenance of securities accounts. This eases the link with the Securities Law Directive and the plans to regulate all securities account providers. We know that the Commission is intending to use MiFID as the main vehicle to authorise the provision of securities accounts. We also understand that some of the proposed MiFID provisions regarding securities account provision could be meant to apply to CSDs in their role of securities account providers. However, we note that most CSDs do not fall within the scope of MiFID because they are neither investment firms nor organised trading venues. We believe that it would be more sensible for the relevant MiFID provisions to be included within the proposed CSD legislation to avoid overlapping regulations. Integrating the proposed safekeeping function as a core CSD function would meet this concern.

The inclusion of "maintenance of securities accounts" in the safekeeping definition is meant to deal with those CSDs that are not really qualifying as "providers of securities accounts" (such as EUI and potentially EF). This ensures that there is no doubt that these CSDs would qualify as CSDs under the Legislation.

Settlement

While this is not really a functional definition, we agree with the Commission's proposed definition. See also our remarks on question 5. We nevertheless point out that not all providers of settlement services are designated SSS under the SFD today.

By referring to the SFD, it should also be taken into account that most CCPs were designated as SSS. Therefore, further assessment will be necessary in order to determine the impact of having a CCP carrying out a CSD core function.

Moreover, the settlement function should not be defined as "operating a SSS" but should rather be covered via the definition of a SSS operator. The definition must however refer to the execution of transfer orders in view of a securities transfer.

Table 1 - CSD "core" services - Summary of Euroclear views

Service	**Definition**	**In practice**
Notary	Initial admission and/or establishment of certificated or dematerialised securities in book entry form	Covers the cases whereby the entity is: ➢ In direct contact with the issuer (keeps issuer accounts) and keeps 100% of the respective securities (e.g. EF) ➢ Top tier of the holding system in book-entry form. It does not have direct contact with the issuer, does not keep issuer accounts and does not keep 100% of the respective securities (e.g. EUI)
Safekeeping	Maintenance and administration of securities on behalf of others, including through the provision or maintenance of securities accounts	Includes securities accounts provision, securities accounts maintenance, safekeeping of securities.
Settlement	Operating a Securities Settlement System as defined in the first and second indent of Art 2(a) of Directive 9/26/EC and whose business consists of the execution of transfer orders as defined in second indent of Art 2(i) of Directive 98/26/EC.	This approach avoids a real functional definition which would be controversial to establish.

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

If it is the intention that all current CSDs are subject to the Legislation, they will request authorisation to become a CSD under the new Legislation (subject to possible grandfathering). Even if a current CSD would not perform all "core" functions as defined, under the new licence, we believe it should be authorised but not obliged to perform all of the "core" functions (on condition of course that it satisfies the related prudential and conduct of business requirements).

The real key question on this topic is therefore: how many and which of the "core" functions should an entity perform before it is *required* to be licensed as a CSD. This relates to the comments made before in relation to questions 1 and 2. In other words, *if* an entity performs some or all of the "core" functions and *if* there is a regulatory gap identified, it should probably become subject to the Legislation.

Moreover, the Legislation should also allow "new entrants" in the CSD business. An entity that is intending to provide core CSD services, should therefore have the possibility to request a licence even if it does not yet perform (any of) the CSD services.

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

We do not believe it is necessary or useful to revisit the definition of "system" in the SFD. While participants may not enter into *agreements* directly with each other, they do enter into "*arrangements*" with each other, typically through the operator of the system. Such arrangements are based on either contract or regulation or a combination of both.

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

We broadly agree with the principles that the Commission is proposing on the scope of ancillary services. As mentioned above, we believe it is important to recognise that some of those "ancillary" services in fact constitute "core" services for some CSDs. The notion "ancillary" should therefore not imply to mean "less important", "not necessarily required" or "value added".

On the proposed principles, we have the following comments:

- We agree with the fact that CSDs should adopt a low-risk business model but want to emphasise that CSDs typically perform functions that aim to take risk out of the market. This has been the very reason for setting up CSDs in the first place. For example, a CSD will ensure that its settlement system provides for an adequate DVP model because this removes settlement risk between the counterparties to the transaction. Similarly, if a CSD provides securities lending and borrowing services, such services will ensure that the number of settlement fails is reduced, thereby

contributing to well-functioning of securities markets. In the assessment of this principle for "new" ancillary services, the regulators should not only look at how the new service impacts the risk profile of the CSD itself, but also if the new service is beneficial for the overall efficiency of, or risk reduction in, the market. It is important that such risk trade-off is reflected in this principle.

The determination of what constitutes a "low risk business model" for CSDs could be interpreted differently and therefore lead to level playing field concerns. We believe that the compliance of "ancillary" services with the prudential and conduct of business requirements of the Legislation should be regarded as compliance with the principle of "low risk". For example, the Legislation's requirements with regard to capital requirements, operational risk management, credit and liquidity risk management could apply across all services provided by a CSD, whether "core" or "ancillary".

- Ancillary services generally contribute to achieve similar efficiency and risk reduction benefits for the market as "core services". For example,
  - EUI operates netting services for LCH, MiFID-related transaction reporting services, and fund order routing services
  - EB operates the FundSettle service.

  To cater for these situations, it may be more appropriate for the principle to state *that "ancillary services have to contribute to enhancing the safety, efficiency and/or transparency of, or the removal of risks in, securities markets"* and be subject to home regulator approval according to the rules set by the Legislation.

- We fully agree with the Commission that the list of ancillary services should not be exhaustive but flexible. This will allow for the different existing CSD models to continue to exist or for new CSD services to develop.

On the list of ancillary services, we note the following:

- We believe that the Legislation should not include a list of potential ancillary services (such a list will never be exhaustive) but rather set as general requirement for ancillary services defined as "any service that respects the principles set out for the provision of ancillary services".
- Should the Commission nevertheless prefer to have an illustrative list of ancillary services as a reference, we have the following comments:
  - It is probably appropriate to add "*services supporting the notary function*"; such services may encompass new issue services (e.g. allocation of ISINs) and specific services to issuers such as keeping a shareholder register, services facilitating shareholder identification, etc.
  - While collateral management services are extremely important for the efficient and safe functioning of securities and cash markets, they cannot just be seen as services that "facilitate" securities settlement. Collateral management services will typically entail verification of collateral eligibility and concentrations, collateral valuation, collateral posting

and substitutions, etc. They should better be defined as "*services facilitating the optimal use of cash and securities positions*".

- There are other *services that facilitate securities settlement* than the ones given in the document, e.g. settlement matching, order routing, trade confirmation.
- With regard to *services facilitating safekeeping and processing of corporate actions*, we can also add the following services: withholding tax management, information services, facilitation of proxy voting services, etc
- On *banking-type services*, banking services provided by a CSD will be offered for use across all core and ancillary services as customers will typically manage only one cash account that will be used for all in-and outflows of cash related to all activities. There is no need to distinguish between the types of core or ancillary services to which the banking services relate.
- As noted above, on the provision of non-central safekeeping of financial instruments, we believe it is better that the "core" service is defined as "safekeeping". Therefore, provision of safekeeping services in *any* security (i.e. regardless of whether the CSD performs the notary service for the security or whether another CSD performs the notary function) should be a core service. This is more in line with a functional approach. If this is accepted, there is no need to foresee (6) as a separate ancillary service category.
- It seems more appropriate to include a separate category of ancillary services i.e. "*any service that respects the principles set out for the provisions of ancillary services*". This would then capture all other services that are not listed explicitly.

We would like to note that the distinction between "core" and "ancillary" is artificial as CSDs will offer these services in an integrated way in order to optimise efficiencies. For example, they use the same technical platforms; share the same securities accounts; the same securities databases, etc.

Table 2 – CSD ancillary services – summary of Euroclear views

Principles	Indicative list of ancillary services	Examples
1. Ancillary services contribute to enhancing the safety, efficiency and/or transparency of, or the removal of risks in, securities markets, AND 2. Ancillary services should be provided in compliance with the Legislation's prudential and conduct of business requirements (which cater for a general low risk profile of CSDs)	➢ Services facilitating the notary function	New issues acceptance, ISIN allocation, issuer services, keeping a register, facilitation of corporate action processing for issuers, etc.
	➢ Services facilitating settlement services	Matching, trade confirmation, order routing, securities lending and borrowing, regulatory reporting, etc.
	➢ Services facilitating safekeeping	Corporate action processing, instruction processing, information provision, withholding tax management, vault management, etc.
	➢ Collateral management services (or services facilitating the optimal use of cash and securities positions)	Collateral eligibility verification, collateral valuation, substitution, etc
	➢ Banking services facilitating notary, settlement, safekeeping, corporate action processing and collateral management services	Provision of cash accounts, credit provision, pre-financing of income and redemption proceeds, etc.
	➢ Other services that meet the general principles for ancillary services	Transaction reporting, netting services, general meeting and voting services, etc.

II. Authorisation and ongoing supervision of CSDs

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

The Commission's consultation document starts from the assumption that whenever a business has a potentially external impact this would require an authorisation and supervisory regime that encompasses the authorities of all Member States involved. In our view this assumption is incorrect, too far-reaching and not based on a sufficiently detailed risk assessment.

In addition, if this concept is carried through into legislation it would mean that the majority of CSDs would be regulated by large colleges of regulators, adding to their (already significant) regulatory burden. This might stifle innovation and the delivery of competitive cross-border services. We believe that the Commission mixes the concepts of home-host regulation with the need for information (on links, foreign participants and foreign securities) to flow between regulatory authorities.

The list of examples of externality identified by the Commission is quite complete, but for the reasons mentioned above, we believe each case and its consequences needs to be assessed individually.

Involvement of regulators of "other" Member States than the home Member State should be limited to cases where there is a potential increase of risk that extends beyond the borders of the home Member State. We would like to stress that there are only a limited amount of cases (described below) which would warrant such approach.

On the cases the Commission lists as externalities, we have the following comments:

- Issuance of securities by an issuer from a different jurisdiction than the CSD

  Broadly speaking, debt securities are already today resulting from European and international issuance. The choice by an issuer of a European or international CSD service provider does not have any particular impact on the issuer's risk profile, and we do not see which risks would mandate a local supervisor of the issuer to participate in the supervision of a foreign CSD.

  As regards equity, the issue is slightly more complex (as discussed in point 3.3 of the consultation) and is connected to national company law and the share capital of the issuers. The regulatory authority overseeing a securities issuer may – in case the issuer decides to issue equity shares into a "foreign" CSD – need to ensure that the *issuer* has dealt with the necessary legal analysis in a satisfactory way.

  Today, in many CSDs there are securities from issuers of other jurisdictions (such as the international debt securities in ICSDs or CSDs, Depositary Interests and Certificates of Deposit in EUI, German warrants in EF). In the current regulatory environment, this does not require that such service offering by the CSD is subject to authorisation of the Member State of the relevant issuer. We see no reason to render the authorisation and supervision process more complex than today. Requiring a CSD to be authorised before accepting the issuance of "foreign" securities in each Member State/jurisdiction of a potential issuer is totally disproportionate for both the CSD and the issuer, and it would lead to an inconsistency with the removal of Giovannini Barrier 9. Therefore, we believe that only the "home" Member State of the CSD should be involved.

- Participation of a member from a different jurisdiction to the settlement function operated by the CSD

Having customers from a number of jurisdictions does not mean that local authorities of those remote customers will have a supervisory interest in the CSD (other than perhaps to ensure conformity with local consumer protection and marketing rules in case of active marketing efforts). If the logic of the consultation paper were applied across all segments of the financial markets, it would mean that in practice virtually all EU regulators would, collectively, supervise all financial institutions.

In the current regulatory environment, accepting customers from other Member States does not require authorisation by the regulators of the other jurisdictions. Requiring a CSD to be authorised in every jurisdiction in which it has customers seems disproportionate for both the CSD and the member. In this case, only the "home" Member State should be involved.

We accept that regulators may wish to exchange information on the number of remote participants in any EU CSD.

- The opening of a branch by the CSD in another Member State

  In this case, the CSD should be able to benefit from a passport and a home/host regulatory regime, similar to the one for investment firms or banks. It will therefore, be the home regulator that is responsible for authorisation and supervision of the branch. There will probably also need to be information sharing between the home and the host regulator.

- The opening of a subsidiary by the CSD in another Member State

  As it concerns the opening of a new legal entity in another Member State, it seems appropriate to require the approval of the regulators of the host Member State.

- The acquisition of an existing CSD in another Member State

  Such situation will require the approval of the regulators of the Member States of both the acquiring entity and the acquired CSD. The Legislation could provide the necessary supervisory framework to deal with such situation and could set formal change of control provisions, to ensure the continuance of fit and proper shareholders for a CSD.

- The operation of a securities settlement system subject to the law of another jurisdiction

  Such a situation will require the approval of the regulators of the Member States of the involved CSDs. The Legislation could provide the necessary cooperative supervisory framework to deal with such situation.

- The conclusion of access and interoperability arrangements between CSDs and with other market infrastructures

  This can be broken down into three situations:

- A CSD opening a link with a CSD ("access") in another Member State.

  Such a link involves the simple opening of a securities account with another CSD (just like any other intermediary would open an account with that CSD). This situation could potentially alter the risk profile of the CSD requesting the opening of an account; for the other CSD, this is just the opening of an account like its other customers. It will apply its general admission criteria and "Know Your Customer" principles. As in the current situation, such case of access only requires the approval of the home Member State of the "requesting" CSD.

- A CSD enters into an interoperability arrangement with a CSD in another Member State.

  The potential cases for interoperability between CSDs are very limited as CSDs would need to offer notary services in the same securities (same ISIN). The only current case of CSD interoperability is the Bridge between EB and CBL which was mainly developed to deal with the specific situation of international debt issuance taking place in both ICSDs simultaneously (same ISIN). In the current Bridge arrangement between EB and CBL, national regulators from both Belgium and Luxembourg are involved. This is as a college of regulators set up specifically to monitor the Bridge.

- CSD accessing transaction feeds from trading venues or CCPs from another Member State.

  We believe this situation only requires the approval of the CSD's regulator. We hereby refer to our comment on the current MiFID text (as included in our response to the Commission's consultation of early 2011) which requires the regulator of the trading venue to approve the settlement venue. Once the Legislation has set a uniform supervisory framework for CSDs, such rule should no longer be necessary. Please also refer to our answer to question 22.

➢ Settlement in a currency different from the currency of the Member State of the CSD.

This situation seems relevant only where the CSD offers multi-currency settlement in commercial bank money. Indeed, if the settlement takes place in central bank money, the CSD is not exposed to any risks related to activities performed in view of facilitating the settlement of the cash leg of the transaction. In this case, when credit is offered, the risk is run by the central bank or by the settlement bank when tiered participation arrangements exist.

CSDs offering multi-currency settlement in commercial bank money will have a banking licence and will follow all related rules for capital and liquidity requirements. As other banks, they will be subject to "home" Member State prudential supervision.

We see no reason why the current authorisation and supervision arrangements would need to be altered although this could be a typical case where there is information sharing between central banks.

- Performing settlement through a common IT platform between CSDs of different Member States

  In these circumstances, we believe there would be a need for oversight of the platform itself by regulators and central banks of the respective Member States, as happens today within the ESES platform operated by the three ESES CSDs. The same should apply in relation to the T2S platform.

Third country aspects

EU CSDs operate not just in an EU context, but also in a broader global one. The above cases would also need to be looked at from such a perspective. We would urge the Commission to ensure that the CSD Legislation respects a competitive level playing field for EU CSDs wanting to compete outside EU. It should also set consistent rules for non-EU entities wishing to provide CSD services in the EU to ensure reciprocity.

Information sharing between EU supervisors

We understand that the increasing cross-border nature of CSD services requires that supervisors have a sufficiently robust framework for sharing information on this cross-border business. The development of information sharing provisions amongst supervisors should not increase the regulatory burden on CSDs. Information sharing between CSD regulators would need to cater for appropriate confidentiality arrangements.

Table 3 – Authorisation and supervision of cross-border elements in CSDs' service offering

Cross-border element	Authorities responsible
Issuance of securities by an issuer from a different jurisdiction than the CSD's	CSD Home Member State only No passport required
Participation of a member from a different jurisdiction to the settlement function operated by a CSD	CSD Home Member State only No passport required
The opening of a branch by the CSD in another Member State	CSD Home Member State Passport required
The opening of a subsidiary by the CSD in another Member State	CSD subsidiary's home Member State No passport applicable
The acquisition of a CSD in another Member State/ Different CSDs in different Member States belong to a same corporate group	Authorities in relevant Member States No passport applicable
The operation of a securities settlement system subject to the law of another jurisdiction than the CSD	Authorities in relevant Member States No passport applicable
Opening of a link with another CSD	CSD Home Member State only No passport required
Entering into an interoperability agreement with another CSD	Authorities in relevant Member States No passport applicable
Access to a transaction feed from a CCP or Trading Venue in another Member State	CSD Home Member State only No passport required
Settlement in a currency different from the currency of the Member State of the CSD	CSD Home Member State only No passport required
Performing settlement through a common IT platform between CSDs of different Member States	Authorities in relevant Member States No passport applicable

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

While we have no particular concerns with the items listed as being part of an initial authorisation procedure, they only represent a fraction of the information which a financial institution provides when it applies for a licence. For example, an application will typically include items such as a description of

governance, the internal control framework and, globally, a description of the business and structure which the entity intends to put in place.

It is unclear what the procedure for a CSD wishing to add an additional ancillary service will look like.

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

We think it makes sense for the SFD designation to be part of the authorisation procedure.

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

ESMA could indeed establish and maintain a register of CSDs. In view of the difficulties of applying the definitions of CSD services, ESMA should also play a role in monitoring the consistency of application of these definitions between Member States.

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

We support the idea of grandfathering of CSDs as there would be no benefit in requiring CSD to re-apply for their licence, and it may even create uncertainty for the market. It is not clear how temporary grandfathering would work in practice. We would prefer that grandfathering replaces the initial authorisation of existing CSDs and that the rules of the Legislation are used for ongoing supervision as of the date of application of the Legislation. Grandfathering should not create level playing field concerns.

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

We broadly agree with the Commission's proposal and note the following:

- For CSDs that do not have a banking licence,
    - the minimum level of equity to be maintained should be commensurate with the risk profile of the CSD (which is very limited)
    - CSDs' total capital requirements could be based on the need to preserve financial capacity to enable them to serve the market for a number of months even if customers are not paying them for the services rendered. In practice this implies that CSDs would need to cover their operating cost during that period.
- CSDs that have a full banking licence would – like today – continue to be compliant with the relevant requirements as set out in the CRD. If the Commission considers that CSDs could opt for a specific "limited purpose" banking licence, we would nevertheless believe that the principles of CRD would need to be maintained but only relevant rules of CRD would apply.
- CSDs often enter into insurance contracts to cover the operational risks they face.

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

We believe the Commission's proposal is adequate.

14. Would a special purpose banking licence be appropriate for "banking type services"?

We are of the opinion that any banking services provided by CSDs should support the efficiency of the core and ancillary services provided by the CSD. There are two broad options:

Option 1 - CSDs have a full banking licence and comply with all related and relevant regulations. This is the case of EB. Under this option, as the CSD will combine its CSD licence with a banking licence, the banking services should be supporting core and ancillary CSD services only. Moreover, the Legislation may determine specific requirements for the management of the related credit and liquidity risk, e.g. in line with the relevant ESCB/CESR recommendations.

Option 2 - CSDs do not wish to be compliant with a full banking licence. We are unaware if there are currently CSDs that operate under such conditions or would want to engage in such activity. At present, the Euroclear CSDs are not considering applying for such banking licence. It is our view that the establishment of such a new "limited purpose" banking licence in the Legislation could be very cumbersome as it would require that all relevant parts of CRD and potentially MiIFD are integrated into the Legislation.

We are in favour of Option 1. This means that no specific special purpose banking licence needs to be developed in the frame of the Legislation.

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

As pointed out in our answer to question 7, we believe a passport will only be needed in case a CSD wants to establish a branch in another Member State.

On the limited, or opt-out, possibilities for passporting, we believe these options do not reflect single market principles as they create regulatory hurdles to competition. Only a full passporting possibility seems acceptable. However, when using the passport, the activities passported should relate to core and ancillary CSD services.

Table 4 summarises the two options for CSDs which offer banking services. We consider that the ICSDs will fall under option 1, which is therefore our preferred option.

Table 4 – Options for CSD offering banking services

Option 1 – CSDs with banking function - two separate licences

CSD functions	Initial authorisation and supervision Licences	Passporting[1]	Prudential and conduct of business requirements
CORE ➢ Notary ➢ Safekeeping ➢ Settlement **ANCILLARY** Services satisfying criteria, e.g. ➢ Services to issuers ➢ Collateral management ➢ Securities lending and borrowing ➢ Etc	CSD licence as defined under Legislation Home regulator authorisation and supervision	Passport for free provision of services Passport for free establishment of branch	Requirements in Legislation only
➢ **Banking services** supporting core and ancillary services only	Banking licence as defined under EU banking regulation, CRD When combined with CSD licence, banking services allowed only to support core and ancillary services Home regulator authorisation and supervision	Banking passport (but the passported banking activities to support core and ancillary CSD services only)	Additional requirements in Legislation (e.g. collateralisation of client exposures, liquidity requirements, etc) AND Standard banking, CRD treatment (where relevant)

Option 2 – CSDs with banking function – one licence

CSD functions	Initial authorisation and supervision Licences	Passporting	Prudential and conduct of business requirements
CORE ➢ Notary ➢ Safekeeping ➢ Settlement **ANCILLARY** Services satisfying criteria, e.g. ➢ Services to issuers ➢ Collateral management ➢ Securities lending and borrowing ➢ Etc	CSD licence as defined under Legislation Home regulator authorisation and supervision	Passport for free provision of services Passport for free establishment of branch	Requirements in Legislation only
➢ **Banking services** supporting core and ancillary services only		Full passport (but the passported banking activities to support core and ancillary CSD services only)	All banking related requirements included in the Legislation

[1] Under the assumption that a passport would be required only to set up a branch in another Member State. As we are unclear about the potential other reasons which would require a passport, we would like to further explore this with the Commission.

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

We agree that the Legislation would include rights of access for market participants. The admission criteria for some CSDs are included in local law. For instance, in France, a CCP can only access the CSD if the CCP is licensed as a credit institution.

ESCB/CESR recommendation 14 probably forms a suitable basis. *"CSDs should have objective and publicly disclosed criteria for participation that permit fair and open access. Rules and requirements that restrict access should be aimed at controlling risk*".

We would like to emphasise that the access rights of CCPs (when they open an account in the CSD for the settlement of their transactions) and of CSDs (when they open an account for a CSD link) are generally the same as those of other regular customers of a CSD.

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

With regard to the removal of restrictions on issuers' choice, we believe following elements have to be considered:

- The implementation of rules related to importability and exportability of securities has to be simultaneous to prevent that a CSD may attract non-domestic issuers, while its local issuers are not yet allowed to move out of the CSD because its Member State has not yet removed the local barriers in full. ESMA could play a role in assessing and monitoring the removal of barriers.
- As we understand that the Commission may propose to exclude some entities providing notary and settlement services from the scope of the Legislation, we believe that the Legislation should not lead to a situation in which securities can be taken out of a CSD and entered into another holding and settlement structure which may subject to less stringent prudential or conduct of business requirements.
- The required accesses must be available where relevant (e.g. transaction feed from relevant CCP or trading venue).
- We believe Legislation should offer the issuer the choice of initial issuance location not only for newly issued securities, but also for existing securities (that could be transferred). CSDs should also have the possibility to refuse securities from other Member States on economic and commercial grounds. For example, the cost of building a link to the CCP or of implementing the necessary issuer requirements may not be acceptable to the CSD or the issuer.
- The rules for abolishing Barrier 9 should not lead to the emergence of unregulated or under-regulated, holding structures to compete with the entities licensed as CSDs. Please also see the response to Question 28 below.

We would like to point out that the costs of free choice for issuers may be high and complex to implement, both for CSDs and for issuers. For example, record dates used to determine dividend and

other distributions depend on relevant corporate law rules and are not harmonised across Member States; in some countries securities are available in physical form which may require the new CSD to set up and manage vaults; the new CSD may need to develop specific procedures for withholding tax processing, etc. In other words, the success of the removal of Giovannini Barrier 9 is very much dependent on the level of harmonisation that is achieved in other areas. It may therefore take many years before the removal of this barrier is achieved.

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

A universal distinction between securities market regulation and company law may sometimes be hard to find. Different Member States may have different demarcations between company law or securities legislation. Furthermore, the Legislation should take into account the practical challenges that emerge for instance, in harmonising, or adapting to, the various national shareholder transparency regimes, which may closely relate to disclosure rules in the context of national taxation. The regulatory framework should also ensure the proper use of shareholder rights, including participation in general meetings and corporate actions. This may require widespread harmonisation of corporate law across the EU.

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

We are neutral as to the question on whether split issuance across several CSDs of the same security (ISIN) should be allowed. We believe it is unlikely that an issuer would choose to split an issue other than across two countries with identical corporate legal structures. Although split issuance may seem less efficient and more risky, we believe it is possible to design reconciliation and realignment procedures to ensure integrity of a securities issuance (this is demonstrated by the well-functioning model for the international debt securities where XS-ISINs are issued into both ICSDs at the same time). However, the related costs of building and maintaining such procedures may result in an uneconomic business case for the CSD or the issuer, e.g. as it could require that systems and procedures need to be adapted for one single securities issuance only. We are therefore convinced that split issuance will, in practice, hardly ever be used.

CSDs therefore, should not be obliged to accept cases of split issuance.

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

With regard to this question, we believe that two aspects have to be considered:

1. The need to cater for open access between CSDs, and
2. Prudential and conduct of business rules that should apply in the cases in which the accesses translate into CSD links or CSD interoperability.

On the first point, direct access by a CSD to another CSD *always* takes the form of a simple opening of a securities account. A CSD should have a standard access right to open an account with another CSD, just like any other CSD customer.

With regard to the second aspect, a CSD may want access to another CSD in order to:

- Open a direct CSD link. Such a link can take the form of "standard access" or "customised access".
    - Standard access means that the CSD simply opens an account with the other CSD and benefits from exactly the same service and prices as the other customers of the CSD.
    - In customised access, the CSD opens an account with the other CSD but, for the actual operation of the link, some specific investments have been made (e.g. to ensure that there is an automated, frequent exchange of transactions during the day). In a customised access situation, the cost of the access will depend on the size of the investment that has been made for the customisation. It is therefore, subject to bilateral agreement (contract) between the CSDs.

  As indicated under question 7 and in Table 3, establishment of a CSD link (standard or customised) should only be subject to authorisation by the Member State of the CSD requesting the access.

- Enter into an interoperability arrangement with the other CSD. Such an arrangement is much more complex to set up, and is a two-way reciprocal link based on specific and mutually agreed requirements. The only current example is the Bridge between EB and CBL. As indicated before, the Bridge is already subject to joint oversight by Belgian and Luxembourg authorities.

With regard to the prudential and conduct of business requirements, we believe that the risks related to CSD links should not be overstated, nor should the regulatory and supervisory set-up be overly complex. It should respect the current arrangements for existing links. The content of the ESCB/CESR Recommendation 19 includes many relevant concerns and risk mitigation elements that could be considered in the context of CSD links and interoperability[2]. We would guard against excessively prescriptive rules on CSD access and interoperability in the Legislation. These proposals go far beyond what has been proposed for CCP interoperability in the frame of EMIR, even though risks related to CCP interoperability are of a different nature and inherently more complex and significant.

For these reasons, we believe that the following topics should not be included in the Legislation:

- *Harmonisation of CSD's account structures*. CSD links can work without harmonised securities account structures. Any harmonisation should be discussed at length with CSD customers and other relevant market players as the market impact could be extensive and will affect national corporate law. We believe such harmonisation cannot be prescribed by the Legislation.

---

[2] Similar rules are used by the ESCB when assessing CSD links for the purposes of monetary policy operations.

- *Remuneration aspects*. These should be dealt with in bilateral contracts, in line with the rules included in the Code of Conduct.
- *Mandatory use of DVP settlement in CSD links*. The Legislation should not mandate that all CSD links permit intra-day DVP settlement as the development of such facilities would be costly and may not have sufficient market demand to justify the investment.

However, we fully support the requirement that the regulatory framework of a CSD should not prevent another CSD from opening an omnibus account in the books of the CSD. This has long been a barrier to cross-border settlement, which we reconfirmed in our response to the Securities Law Directive in January 2011.

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

With regard to access rights of CCPs, a distinction should be made between:

- A CCP right to choose a settlement location/CSD
- A CCP right to open an account in a CSD

The first right would ideally have been included in EMIR (but to our knowledge has not been included yet) and can also be included in the Legislation.

The second right is included in the general right of access to a CSD as covered under question 16. Indeed, as counterparty to the cleared transactions, a CCP will need to open an account with a CSD for settlement and safekeeping purposes.

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

We want to highlight our long-standing concern about the implementation of certain articles of MiFID related to access to clearing and settlement facilities. We believe that there are regulatory and other barriers which hinder the delivery of the full benefits of access and interoperability across trading, clearing and settlement layers.

More specifically MiFID article 34 §2 and 46 could be regarded as part of these regulatory barriers, potentially resulting in level playing field issues. The aim of MiFID articles 34, 35 and 46 (together with the Access and Interoperability Guideline of the Code of Conduct) was to increase competition, both at CCP and CSD level, and to provide investment firms with a choice of settlement location. Euroclear has experienced some difficulties in exercising its access rights which we believe are related to the way MiFID is implemented in some Member States.

Under MiFID Article 46(2) the competent authority of a regulated market cannot oppose the use of a settlement system in another Member State unless this is "demonstrably necessary in order to maintain

the orderly functioning of that regulated market". This provision also refers to Article 34(2) of MiFID, under which Member States must require that regulated markets offer their participants the right to designate the settlement system, subject to (i) links/arrangements which are necessary for the efficient and economic settlement of the transaction in question; and (ii) agreement of the responsible authority for the supervision of the regulated market that the technical conditions for settlement are such as to allow "the smooth and orderly functioning of financial markets". In addition, the competent authority's assessment must take into account the oversight/supervision of the settlement system already exercised by the authorities with competence for this system (a form of mutual recognition).

These articles imply that it is the supervisory authority of the Member State on whose territory the regulated market/MTF is located that needs to agree on the assignment of a settlement system in another Member State. We are not convinced that this is the most adequate way to ensure freedom of choice of the settlement location. Certainly once there is a formal EU CSD licence, it will be more suitable that the supervisory authority of the Member State of the CSD assesses whether the addition of settlement transactions from a regulated market/MTF from another Member State still allows the smooth and orderly functioning of the settlement system (see also our response to question 7).

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

Yes, without such right, CSDs will not be able to compete for settlement flows. This was agreed as a principle in the Code's Access and Interoperability which was signed by market infrastructures at trading, clearing and settlement level. A CSD should have the right to access a transaction feed from a trading venue or from a CCP.

These access rights would complement the access rights that are included in MiFID and EMIR. It may have been a better solution to include an obligation of trading venue and CCPs to provide access to transaction feeds in MiFID and EMIR respectively. Including the access rights for CSDs only in the Legislation will mean that the resulting obligation on trading venues and CCPs is included in another legislative instrument which may not be optimal from a consistency viewpoint. Moreover, we believe this entails risks that the rights and obligations of the market infrastructures are not appropriately "mirrored" across the various legislations.

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

To be able to compete with the incumbent CSD on the provision of settlement services, a CSD needs two accesses:

- Access to the transaction feed of a trading venue or a CCP, as well as
- Access (opening of account) to the incumbent CSD (to build a standard or customised link)

We believe that the language of the Code of Conduct Access and Interoperability Guideline could be taken as a basis.

III. Prudential rules and other requirements for CSDs

As a general comment, we point out that the Commission document is flawed on the analysis of the risks incurred by CSDs. Section 4.1 states that "CSDs are subject to a number of key risks" and lists many risks which are not incurred by the CSD itself but by market participants. It therefore gives the false impression that the CSDs themselves face substantial risks. We are not sure that the differentiation made by the Commission between risks incurred by Securities Settlement Systems (SSS) and CSDs is relevant in this context.

It may be better to differentiate between (i) the risks that are effectively incurred by a CSD, and (ii) the risks that are incurred by market participants. For the first set of risks, if they are material, CSDs could be subject to prudential rules of the Legislation; for the second, CSDs could be subject to specific conduct of business rules in the Legislation (and to central bank oversight). Of course, as there is no obligation for market participants to effectively use the framework put in place by the CSD, CSDs should not be held responsible if market participants decide to use other venues than CSDs for e.g. safekeeping, settlement, securities lending and borrowing, etc.

We question the statement on page 21: "From a financial stability point of view, these risks converge into two more fundamental risks which are liquidity risk (due to a delay in settlement) and settlement risk (due to absence of settlement)". Those two risks are not risks incurred by the CSD but by market participants whenever settlement is not done through a DVP mechanism.

We are not sure what is meant by 'pre-settlement risk' and how securities lending and borrowing could mitigate this risk. Pre-settlement risk is not a well-defined and accepted term in either CPSS or ECB glossaries. We believe the risk described is settlement risk. The definition of settlement risk is not restricted to settlement in an SSS but applies to all settlement locations (and not only to securities but also to foreign exchange transactions).

Risks incurred by CSDs:

- Legal risk
- Operational risk
- Credit and liquidity risk (if the CSD offers credit facilities to its customers and/or provides settlement in commercial bank money)
- Limited custody and settlement risk (only for own account transactions and investments and only in case the settlement is not executed on a DVP basis; the risk is therefore extremely small compared to the CSD activity performed for customers)

Risks that are incurred by CSD customers and for which the CSD could be requested to put in place contracts, systems or procedures to mitigate the risk:

- Legal risk
- Settlement risk
- Custody risk

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

While we agree that CSDs have to ensure that their legal framework is sound and transparent in line with ESCB/CESR recommendation 1, we are not in agreement with the Commission on some of the concerns raised on page 22 of the consultation document.

It is very important to define what is meant by "interoperability arrangements between CSDs" in the context of this question. It is our understanding that the interoperability rules of the SFD have not been designed with CSD cross-border links in mind. As pointed out before, we do not believe that CSD links should be considered as interoperability. We do not see how, in practice, the moment of entry/irrevocability in a link could be defined in an identical manner in the rules of two CSDs which separately receive and treat an instruction. As regards CSDs which operate a interoperable arrangement (such as the Bridge between EB and CBL), it is obvious that the rules must be coordinated, but we do not see why they have to be identical.

In the context of T2S, we see advantages in ensuring that all markets which have outsourced their settlement platform and processes to T2S have the same interpretation and implementation of the SFD.

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

In the interest of overall certainty in the market and taking into account that CSDs operate links with each other, we support the proposal that all CSDs should be subject to a designation/notification.

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

We agree that central securities lending and borrowing facilities do increase settlement efficiency as they can ensure that securities are automatically borrowed if insufficient securities are available on settlement date. This therefore sharply reduces the risk of settlement fails and increases settlement efficiency.

There are broadly three mechanisms in place: (i) centralised services offered by CSDs like EB, (ii) bilateral arrangements through some of the CSDs (such as EUI), or (iii) bilateral arrangements outside CSDs.

The centralised automated service offered to customers of EB requires EB to take credit risk since it guarantees the return of lent securities to the lender. This risk is duly collateralised. Borrowers must have a credit line with EB and the total amount they can borrow is limited by a borrowing cap. This credit facility is set up on the basis of a credit analysis by EB's credit department and includes a collateral arrangement with EB where borrowers pledge assets to the benefit of EB. In addition, appropriate haircuts are applied to cover asset value volatility. This sort of service typically requires a banking licence.

Centralised automated securities lending and borrowing facilities could also be considered without the CSD taking credit risk, but to our knowledge they currently do not exist.

Bilateral lending and borrowing is used for settlement optimisation in some CSDs (EUI for instance). In this case, no central facilities are provided. Lending and borrowing can take places in the full range of securities in system and is purely a bilateral process with no central or intermediary part played by the CSD.

As a third possibility, there are securities lending and borrowing arrangements outside CSDs.

We are not in favour of a rule that would mandate CSDs to offer securities lending and borrowing facilities. Such facilities should only be established if there is sufficient market demand, and if they can be offered with the necessary safeguards. If they would be mandated by the Legislation, it would make sense to include them under "core" services.

As noted above, the concept of "pre-settlement risk" is not clear, nor its difference with settlement risk. It is also unclear which parties would incur such risk. To our understanding, CSDs do not incur such risk.

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

Establishing securities in book-entry form, by dematerialisation or by immobilisation, certainly has its merits from a risk and efficiency viewpoint. To our knowledge, the overwhelming majority of EU securities are already available in book-entry form. But there are some Member States where many physical certificates are kept in private vaults or where dematerialisation is voluntary and at the option of the investor.

Today, even for securities available in book-entry form, issuers do not only issue their securities into CSDs. For example, in Belgium, for non-listed securities, issuance can take place in other entities than Euroclear Belgium; in France, bank certificates are issued on the books of banks, in Italy, securities in paper form are issued by the issuer and, in most cases, are kept in custody by commercial banks. For

investment funds such a function is more often performed by transfer agents (on behalf of fund management companies) than by CSDs.

Usually the admission to the CSD is driven by the listing rules or, when there are no specific listing rules, the willingness of the issuer to facilitate the circulation, the settlement and the custody of its securities among financial intermediaries.

We are in favour of a rule requiring issuers to pass the securities through a CSD as soon as the issue needs to circulate among financial intermediaries, with the objective to avoid the risk and complexity of creating parallel settlement channels.

We nevertheless believe Member States should decide if all securities should be issued into a CSD and if securities should be available in dematerialised form only. If it would be mandated, it would potentially be a huge change e.g. to the UK and Irish registration models. This would be at odds with the exemptions that are proposed by the Commission at the beginning of the document.

29. What is your opinion with respect to grandfathering?

See above.

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

We have no knowledge of particular failures in the way CSDs currently implement DVP settlement. It is our view that the requirements currently included in the ESCB/CESR recommendations (potentially reviewed by CPSS/IOSCO) are adequate and do not need change.

We believe that some of the statements in section 4.5 give an incorrect picture of the DVP requirements and of the protection provided by the Settlement Finality Directive. It is not entirely correct that DVP complements the SFD. DVP is a mechanism which protects the parties to a transaction against counterparty (settlement) risk whereas the SFD is a legal measure which ensures that settlement, including DVP transactions, are protected to the fullest extent in case of the insolvency of one of the parties to the transaction.

- DVP, in its purest form (DVP model 1), is a technical means to achieve simultaneity between both legs of the transaction. In a way, it is similar to PVP in foreign exchange transactions, where it is ensured that both currencies are exchanged at the same time. In foreign exchange settlement, the risk that one leg of the transaction is processed, and that the other is not, following the insolvency of one of the counterparties, is called Herstatt risk. If that risk materialises, the surviving counterparty is at risk of losing the full principal amount of the trade.
- Finality is the legal means to ensure that transactions cannot be unwound in case of insolvency. Finality can apply to DVP as well as to free of payment (FoP) transactions. In case of FoP

transactions, a cash movement may occur outside of the settlement system; it is often the case that both 'legs' of such a transaction are final, though not simultaneous. Indeed, the associated cash transactions tend to be processed in designated payment systems. However, if there is no simultaneity, there may be a possibility for one of the counterparties to delay, and eventually block, the provision of cash or securities.

We believe there are two inconsistent statements in the Commission's text: on the one hand, it is stated that "future legislation could require […] the use of DVP for all securities transactions against cash", and on the other that "an exception could be provided for certain "Free of Payment" transfers". Why would an exception be needed, if the rule only concerns transactions against cash?

We are not sure to understand the statement that DVP presents a constraint as it would require the counterparties to immobilise their securities and cash during the "matching period". DVP settlement does not require "blocking" of securities or cash.

In certain circumstances, transactions will settle Delivery versus Delivery (of securities), e.g. in collateral management transactions.

Please note that a CSD can merely provide a DVP settlement system, it cannot oblige its customers to use it (they may execute their settlement outside of a CSD) nor can it prevent its customers from using FoP instructions. The Commission may consider obliging CSDs to offer DVP facilities, though it cannot and should not restrict customer choice. We therefore wonder whether the Legislation is the right instrument for including requirements on the use of a DVP settlement functionality.

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

This would assume that there are providers of CSD services that currently do not operate under suitable DVP rules. We are unaware if there are such CSDs.

It is unclear which risks the guarantee fund would address; who would set it up, on which basis it would be funded and by whom.

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

While we can understand that there is a preference for settlement in central bank money, we wish to emphasise that settlement in central bank money is not the only possibility to ensure safe settlement. This is generally recognised e.g. by the European Central Bank which states in the September 2010 textbook on payment systems "*the two extreme alternative arrangements of mono-banking (where the central bank acts as the sole issuer of money) and free banking (where commercial banks provide all the money required by the economy) have not proven to be sufficiently stable or efficient. Thus, central bank*

and commercial bank money typically coexist in a modern economy, and this coexistence should be preserved."[3].

A preference for central bank or for commercial bank money settlement is unrelated to the type of securities that is presented for settlement.

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

We agree with the Commission's analysis that there are cases where settlement in central bank money is not practicable or feasible. Indeed, the overarching reason for using commercial bank money is that the relevant transactions involve a cross-border element relating to the settlement counterparties, the settlement currency, the currency of custody proceeds, or the denomination currency of the security. Commercial bank money settlement will then generally be the only feasible solution, e.g. when:

- Secondary market settlement happens in many different currencies which makes settlement in central bank money not a practicable option;
- Access to central bank liquidity or central bank credit is not available to all CSD customers. These customers therefore, will always need a commercial bank for their settlement. Such commercial bank can either be a CSD that offers commercial bank money settlement or can also be another commercial bank (typically referred to as (cash) settlement bank);
- New issuance of international securities (Eurobonds) is taking place in well over 40 different settlement currencies, making commercial bank money settlement the only practicable option;
- Proceeds from corporate actions, tax reclaims, redemption and income payments are paid in commercial bank money and customers want to re-use these proceeds for their settlements, including for primary market trades, as this allows them a more efficient cash management.

Of course, provision of settlement in commercial bank money in a CSD requires that this CSD provides cash accounts to its customers, and potentially provides credit. Such service offering therefore requires a banking licence.

From a risk viewpoint, the key difference between both settlement assets is the likelihood of the failure of the provider of the settlement assets (central bank or commercial bank) for credit or liquidity reasons. Where it is generally accepted that a central bank will not be able to default, a commercial bank could. This is why the providers of the CoBM cash asset will engage in very strict risk management techniques to ensure their risk of default, or of severe liquidity pressures is extremely limited (e.g. very short term credit provision, collateralisation of credit exposures, provision of uncommitted credit facilities only, liquidity stress testing, etc).

[3]Kokkola, T., The payment systems: payments, securities and derivatives, and the role of the Eurosystem, European Central Bank, Frankfurt am Main, September 2010, p. 45, 369 pp. Available at http://www.ecb.int/pub/pdf/other/paymentsystem200909en.pdf

In addition, CSDs that offer CoBM settlement currently only provide banking services that are related to core and ancillary CSD services. As banks, they are subject to the standard EU banking and capital requirements regulation. In practice, they tend to hold capital in excess of the regulatory requirements.

The best proof that the provision of settlement in commercial bank money can be organised in a very safe manner is that EB has never suffered a single credit loss since its inception in 1968.

We do not understand the references to a "two-speed" system after the introduction of T2S. Those CSDs that settle in central bank money today in the eurozone (and beyond) are considering whether to outsource their settlement platforms to T2S. Those that settle in commercial bank money today will continue to do so post T2S. Central and commercial bank money settlement are alternative settlement mechanisms that co-exist today. T2S does not create a two speed Europe.

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

The Legislation should probably set out the key requirements only. For example by using the ESCB/CESR recommendation 10 :"*Assets used to settle payment obligations arising from securities transactions should carry little or no credit or liquidity risk. If central bank money is not used, steps must be taken to protect the participants in the system from potential losses and liquidity pressures arising from the failure of the cash settlement agent whose assets are used for that purpose.*" Further implementing standards should be left to ESMA and ESCB. We believe that the principles that are currently included in ESCB/CESR recommendations 9 and 10 would form a good basis.

35. What do you think about the rules above?

Generally, these rules are in line with the good practices already imposed by oversight standards. We are however concerned that if the SLD moves forward, CSDs will be subject to a cumulative set of rules (given also the references to MIFID) and would prefer that any rules applicable to CSDs be consolidated in the Legislation.

Although we are not commenting on the details of any rules at this stage, we would like to point out that any text should avoid references to investors (see 2nd bullet) as not all CSDs hold accounts for investors.

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

Not all CSDs have been set up with the duty to ensure the "integrity of the securities issue"; e.g. ENL, EUI and EB. Only those CSDs that have a direct relationship with the issuer and maintain issuer accounts should therefore comply with such requirement. All CSDs, like any other securities account provider in a securities holding chain, should have a task of reconciliation.

Segregation requirements whereby a CSD customer should segregate its own securities from those of its customers are not requirements upon the CSD itself. The CSD should ensure that its service provision allows customers to meet their own segregation requirements.

A segregation requirement only falls on the CSD in case it holds own securities in which case it has to ensure that it keeps segregated accounts for its own securities versus the securities of its customers.

We agree that such requirements will be included in the Legislation, but stress that there are several legislative instruments that require reconciliation and segregation from other parties in the securities holding chain (MiFID, AIFMD, UCITS).

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

The basic principles are appropriate. Note, however, that CSDs also need to comply with the ESCB-CESR recommendations. Recommendation 11 covers Operational Risk in greater detail than the proposed content of the Legislation. We believe the Legislation should refer to the ESCB/CESR recommendations. In addition, CSDs that have a banking licence are subject to the operational risk requirements included in the CRD.

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

We believe that it could be detrimental to good corporate governance to turn prescriptive proposals into hard law or regulation as opposed to the current "comply or explain" nature of governance codes in many Member States. Many principles of corporate governance are qualitative and judgmental in nature and do not lend themselves to hard law or regulation. In addition, effective and good governance results from the substance of governance arrangements in place and the behavior underlying them, rather than formal adherence to a set of specific rules. For example, Euroclear's experience where the definition of an "independent director" has been enshrined into national regulation, is that strict compliance with a detailed regulation can produce anomalous results that are not always conducive to the most effective governance for the institution in question.

We are favourable to the principle of a risk committee, but believe that the Legislation should not specify where in a group structure which includes a CSD such a risk committee should sit. The Euroclear Group has a risk committee at group (Euroclear SA) level.

A compulsory requirement for each CSD to set up a risk committee could be burdensome and may be disproportionate for smaller CSDs.

We would like to point out that CSDs already provide considerable transparency on their risk management practices, e.g. through SAS 70 reports, BIS Disclosure Framework reports, and CRD Pillar 3 disclosure (where applicable).

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

Yes. This is in line with general outsourcing guidelines.

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

We note that the Commission proposes to certain exemptions to regulatory outsourcing requirements when a CSD outsources to the Public Sector. This exemption is unique for CSDs and has no equivalent in EMIR nor is it mentioned in the MiFID consultations. We believe that any outsourcing must be assessed according to the same regulatory rules. We would like to understand the rationale for introducing a precedent either in relation to one specific development (T2S) or for all public entities.

The result of exempting CSDs from certain outsourcing requirements is that regulators will no longer have a role to play in the supervision of the related outsourcing arrangements. The key question therefore, is if Member States will be comfortable giving up certain regulatory powers, and which authority will bear the responsibility in case of problems with the outsourcing arrangement. We also would like to understand what would be the impact of such provision on CSD liabilities and if and how these liabilities would be covered by CSDs or market participants through capital requirements or insurance.

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

- For CSDs that do not provide banking services, we believe the Legislation should probably set some minimum capital requirements along the lines of section 2.5 and question 12 to deal with any credit, liquidity and market risk they would incur (as such risks will be very limited). We see no reason to include other requirements as this would be disproportionate to the materiality of the risk incurred. In particular, the reference to custody risk does not seem entirely appropriate in this context. Indeed, the risk of loss of securities - although very remote - exists, but it is a custody risk only from the point of view of the customers of the CSD. From the point of view of the CSD itself, this is treated as operational risk that may be covered by insurance, loss-sharing arrangements or, ultimately, by its capital. The solution to any loss will have been foreseen by law or by the rules of the system, representing an adequate distribution of risk between the different players.

  We believe the description of financial risks borne by CSDs not offering any banking services gives an inaccurate picture of the risk profile of such CSDs. As explained above, custody risk borne by the CSD only concerns CSDs' proprietary investment assets. In addition, the main risk related to depositing cash surpluses is credit risk, rather than liquidity or market risk. Credit risk is mitigated through the use of very well-rated counterparties. Liquidity and market risk are limited by either maintaining cash deposits, or investing in safe and liquid instruments.

Even if the CSD loses its own cash surpluses or its investment assets, it is unlikely to run into bankruptcy. In the worst case, it may bring total capital below the level required by the regulator.

- For CSDs that provide banking services, we agree that the Legislation could include a high-level rule on the management of credit and liquidity risk. We believe that such rule should be consistent with the content of the ESCB/CESR recommendation 9, and should take into account requirements that come from banking regulation and CRD. Moreover, the more detailed implementation standards may need to be determined by ESMA and ESCB.

  We point out that some of the measures proposed by the Commission are more restrictive than those agreed within the framework of the ESCB/CESR Recommendations. These restrictions would pose a structural threat to the economic viability of the ICSD model:

  - The requirement that credit extended to customers is *fully* collateralised. While EB achieves a very high level of collateralisation (99%), the remaining part is very difficult to collateralise (e.g. because the customer is a central bank);
  - The requirement that credit can only be collateralised with assets comparable to the ones required by central banks for the collateralisation of monetary policy operations. Non-ESCB-eligible collateral should remain allowed, as long as an adequate haircut is foreseen;
  - The limitation of the credit provision to 48 hours. Again, while most of the extended credit results in exposures lasting less than 48 hours, there are situations (e.g. due to time zone differences) where credit is provided for a marginally longer period.

As EB has a "full" banking licence, it is indeed subject to, and compliant with, related banking requirements, CRD and MiFID.

42. What do you think about the principles above?

The scope of 4.12 is very unclear and appears to suggest that CSDs should substitute central banks or other liquidity providers in preventing settlement failures for lack of credit or liquidity when a CSD is acting as facilitator in the provision of credit. If this refers to the role that some CSD play in managing the payment leg of DVP transactions in CeBM, we believe that rules should be applied by the ESCB or relevant central bank. If it refers to a situation in which settlement banks take care of the cash leg of settlements, requirements should then be addressed to such settlement banks, not to CSDs.

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

We agree that some of these provisions could find their way in the Legislation but insist that if these provisions of the Code are applicable to CSDs, they should also be applicable to CCPs and trading venues, as was set out in the Code. We are unsure why the Commission wishes to restrict the Code elements solely to CSDs.

On service unbundling and accounting separation, the Commission should be aware that principles 39 and 42 of the Code also includes requirements for service unbundling and accounting separation in corporate groups that include providers of trading, clearing (CCP) and settlement services (vertical silo's). The integration of these principles would require that MiFID and EMIR contain such provisions.

If the Commission is not planning to include the Code provisions on these topics in MiFID and EMIR, we believe they should not be included in the Legislation either as this could lead to level playing field concerns.

Part II Harmonisation of certain aspects of securities settlement in the European Union

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

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

We have for many years supported the various initiatives aimed at bringing about greater harmonisation through the work based on the Giovannini barriers in the context of CESAME and related working groups. Euroclear has promoted and spearheaded the harmonisation of market practices across its group markets in support of the development of shared solutions for these markets. For instance in ESES (Euroclear Settlement of Euronext-zone Securities), the market participants from the CSDs of Belgium, France and the Netherlands process all securities transactions on the same consolidated settlement platform using harmonised procedures and streamlined market practices.

Many harmonisation efforts have reached the boundaries of what could be agreed between market participants on the basis of private sector initiatives. Further harmonisation of post-trade processes is often constrained by differences in the legal and fiscal framework of the markets. While we appreciate that a separate consultation on the harmonisation of the securities law across the EU consultation aimed to streamline the legal frameworks for acquisition and disposition of securities, we are afraid this legislative track did not go far enough in tackling some of the real practical obstacles to cross-border holdings and dispositions, such as blocks on the use of multi-tiered structures or omnibus accounts.

5. SETTLEMENT DISCLIPINE

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

The definition of what constitutes a failure in settlement should be kept at a very high level and make use of generic terminology. Because the reasons for settlement failures are so wide and diverse (e.g., failure to deliver physical securities, operational errors such as wrong/late input or matching instructions, breakdowns in chains of back-to-back transactions, etc.), there would be limited merit in trying to define in more exhaustive detail the reasons of settlement fails as part of the definition. We believe the key elements of the definition as proposed in the consultation paper are adequate:

> '*A settlement fail occurs when a securities transaction does not settle on the intended settlement date.*'

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

Market discipline regimes are designed to promote and maintain overall high matching and settlement efficiency rates and as such touch a broad range of transaction types, processes and actors intervening from trading, clearing to settlement. To ensure the highest possible settlement efficiency, a combination of ex-ante and ex-post measures will generally be used at the settlement layer: early matching of instructions, multiple batches for settlement processing during the day, processes ensuring optimisation for chains of transactions, specific reporting and monitoring of settlement fails, automated securities borrowing, settlement discipline (buy-ins, penalties), etc.

Settlement discipline is therefore merely a sub-group of market discipline measures operated by a wide range of infrastructures. This is therefore an issue which is not only relevant at the level of the CSDs but also for trading venues, CCPs and regulators.

It is therefore questionable if, besides high-level principles and objectives aiming at maintaining a high settlement efficiency rate, this Legislation is the appropriate vehicle to contain any detailed provisions on market discipline measures. We believe it is far better for the CSD and the market participants to decide which measures (and combinations thereof) best achieve such high-level objective. Where relevant, ESMA - in dialogue with market participants – could set out detailed requirements as part of Level 2.

We believe that any possible legislative action in the area of market discipline regimes should consider level playing field aspects and the potential for regulatory arbitrage if the proposed measures would be applicable only to transactions executed on trading venues, cleared through CCPs and settled in settlement systems. Imposing market discipline measures only on transactions flowing through the "traditional" market infrastructure route could have as unintended consequence that activities would move away from this infrastructure route.

Finally, the discussion on the modalities of a harmonised EU settlement discipline regime and the timing of its introduction will need to take into account future development resulting from the call for shortened settlement cycles (see further) and the implementation of T2S.

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

We support measures to improve matching and settlement efficiency and provide services and tools to our customers to ex-ante manage their instruction flow and to achieve the highest possible settlement efficiency.

It is to be noted that settlement efficiency across Europe overall is very high reaching levels of 98% by value and 97% by number of transactions (despite the fact that not all CSDs have settlement regimes in place).

As stated in our answer above, we think that this Legislation should only contain high-level principles and objectives for settlement discipline and not detailed provisions for any ex-ante measures.

While a harmonised framework for collection, monitoring and reporting of data regarding settlement fails to regulators and/or markets may well contribute to improved monitoring by competent authorities of comparable data across markets and CSDs, its actual implementation will need to build on a detailed assessment of existing practices across the different markets and CSDs. ESMA could to that end play a helpful role in establishing standards for uniform detection and calculation of settlement fails across instruments and relevant markets.

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

The consultation paper suggests that future regulation may contain high-level rules on harmonised penalty regimes and enforcement rules such as buy-ins and cash compensation rules building on article 13 of recent Commission proposals on short selling.

Settlement penalties

This proposed article 13 of the Short Selling Regulation contains provisions stating that the CSDs would, within the context of settlement discipline regimes, take a role in levying penalties. Together with the European Central Securities Depositories Association (ECSDA) we have argued that discussions on short selling measures should be dissociated from discussions on settlement discipline regimes, because the latter aim to promote and maintain high settlement efficiency rates and their level makes them inadequate deterrent to uncovered short sales. We have also argued that CSD are in no position to levy penalties to deter short selling specifically as they have no means to identify whether a settlement fail is due to short selling or another technical reason (which as stated earlier can be due to many reasons other than naked short sales).

Buy-ins

With regard to the entity responsible to execute buy-ins, we restate our position that CSDs are not parties to the trade. Giving them a role in the execution of buy-ins would require the CSDs to take on principal risk, which would change their risk profile (and may require them to have a banking licence). We therefore believe that any obligation to execute buy-ins should be on the parties directly involved in the transaction. For instance, the parties to the trade could instruct and execute a buy-in themselves possibly under the rules of the trading platform on which the trade was conducted eventually with the trading platform as principal (as it is the case in some Member States already today). If the CCP is a party to the trade, it could also be given the role to instruct such buy-in. But, however structured, buy-ins is no guarantee of the original failed transaction settling if the security to be bought-in cannot be sourced.

6. HARMONISATION OF SETTLEMENT PERIODS

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

Euroclear is involved closely with the work of the Working Group Harmonisation of Settlement Cycles set up by CESAME and now working with EGMI and we support its conclusions with regard to the case for harmonising settlement cycles and the role of harmonised settlement cycles in corporate action processing.

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

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

CSDs are broadly neutral to this question since they can already accommodate much shorter settlement cycles. In many instances transactions are being entered on trade date for same day DVP settlement. If the parties agree to this and they manage to take care of all required processes, they can effectively settle on a same day (T+0) basis.

Clearly any move to shorter settlement cycles must be consistently applied across trading venues. In addition, market efficiency must not be impeded through a large rise in settlement fails.

We would stress that CSDs cannot enforce settlement cycles which are merely one part of the contract struck at the point of trade. In addition, settlement discipline may not be able to incentivise the maintenance of settlement rates if market participants themselves are not able to manage the reduction of settlement cycles (because, for example, of a lack of automation of trade confirmation processes).

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

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

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

That is a question that is best left to the markets and should be discussed on the context of the work of the Working Group Harmonisation of Settlement Cycles.

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

We believe that any regulatory regime requires an adequate sanction based regime for those that the regime licences. However, we would encourage the Commission to take into account the infrastructure role of CSDs in any assessment of future sanctions.

In the cases where financial sanctions are applied to a CSD for errors made by an institution to which that CSD has outsourced its settlement (or other) platforms, CSDs would require the right to be able to pass the sanction on to the supplier in its entirety. The supplier should not be able to recharge such a fine back to the CSD as a general cost of the outsourcing.