

Chapter 16

The Changing Role of CSDs in the Post-Trade Industry in Europe

Impact of the CSD-Regulation and T2S

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ABSTRACT

In this chapter Central Securities Depositories (CSDs) are analyzed, in playing an essential role in the European post-trade market. The background is presented, describing their services both on domestic level, and in a cross border context in Europe. CSDs have introduced (self) regulation and this chapter outlines the efforts they are making to remove existing barriers in a still fragmented European post-trade market, in order to achieve more efficiency. Particular attention is given to the changes and challenges the CSDs face with respect to the Central Security Depository Regulation (CSDR) and Target2-Securities (T2S), which is an initiative of the Eurosystem and is expected to go live as of June 2015. T2S will connect CSDs within the European area, performing as a cross border securities settlement engine.

1. INTRODUCTION: THE FUNCTIONING OF CSDs AND THE IMPACT OF CSD REGULATION AND THE IMPLEMENTATION OF T2S

The smooth functioning of the post-trade industry, including settlement, is essential for Europe's economy, and the working of capital and financial markets. CSDs (including the SSS function, see box 1) play a crucial role in securities settlement industry and they need to comply to rules and regulations aiming at the smooth, safe and efficient functioning of the post-trade market.

Cross border securities settlement in the EU is still complex and complicated. Market parties have put an effort and made progress in breaking down to so called private sector "Giovannini barriers". These barriers were identified in 2001 by a group chaired by Alberto Giovannini as the sources of fragmentation.

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Furthermore, they came up with the European Code of Conduct for clearing and settlement in 2006 to which they committed themselves, to comply to rules with a view to improve transparency and access.

In 2012, CPSS and IOSCO replaced and harmonized three existing sets of international standards set out for systemically important payment systems, securities settlements systems, and central counterparties, with the Principles for Financial Market Infrastructures. These Principles provide for minimum requirements and more detailed guidance to cover new risk-management areas and new types of FMIs.

Furthermore, further harmonization through the whole cross border settlement chain for different kind of products and services was needed to further improve efficiency. The industry needed a further push by means of the CSD-Regulation (CSDR) and the initiative of the Eurosystem, Target2-Securities (T2S).

The European Commission was of the opinion that CSDs, playing a crucial role in the securities market, would need their own rules by means of the CSDR. The objective of the CSDR is to improve safe and efficient cross border securities settlement, by enhancing legal and operational conditions for settlement, and laying down uniform requirements. The CSDR should follow the Principles for financial market infrastructures developed by CPSS-IOSCO. The Commission and European Securities and Markets Authority (ESMA) should ensure consistency with existing standards and their future developments when drawing up or proposing to revise the regulatory technical standards and implementing technical standards as well as the guidelines and recommendations referred to in the CSDR, in close cooperation with the ESCB.

Furthermore, the Eurosystem has an interest in safe and efficient settlement of these securities, especially on a cross border basis. Therefore, around 2006 the Eurosystem central banks and the ECB took the lead in developing a platform, Target2-Securities (T2S), which should make cross border securities settlement more easy.

2. CSDs SERVICES TODAY, INCLUDING SSS FUNCTIONS

CDS perform custody services (registration and safekeeping) and activities related to issuing, including bringing new issues to the market, asset servicing, asset protection, asset safekeeping for several securities instruments, corporate actions, fund business. Furthermore, they carry out the settlement of securities in exchange for cash and the processing of securities transactions in financial markets.

Box 1. The definitions of both a SSS and a CSD which has slightly been changed during the last decade

Central Securities Depositories (CSDs)

A CSD plays a crucial role in the securities settlement industry, safekeeping securities and processing these by book entry. In 2001 CPSS IOSCO recommended that securities should be immobilized and transferred by book entry in CSDs to the greatest extent possible and CPSS IOSCO provides guidance with a set of principles for CSDs. According to CPSS IOSCO CSDs have unique risks associated with their function and design. A CSD should therefore have appropriate rules and procedures in place to help ensure the integrity of securities issues, minimize and manage the risks associated with safekeeping and transfer of securities. According to the Principles for financial market infrastructures, a CSD should maintain securities in an immobilized or dematerialized form for their transfer by book entry as mentioned in the Today, in market practice, a CSD often perform SSS functions, incorporating confirmation, clearing and settlement functions.

Securities Settlement Systems (SSSs)

In 2001 an SSS was defined as an institution which performs the full set of arrangements for confirmation, clearance and settlement of securities trades and safekeeping of securities across a securities market. An SSS can furthermore be described as a system permitting the transfer of securities either Free of Payment (FoP) or Delivery versus Payment (DvP). The most recent definition of CPSS/IOSCO of an SSS is more narrow: an SSS enables securities to be transferred and settled by book entry according to a set of predetermined multilateral rules. In many countries CSDs also operate an SSS but this is not included in the more narrow definition of a CSD. There are several entities which combine the functions of both an SSS and a CSD (BIS, PFMI, CPSS IOSCO 2012).

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