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IMPACT ASSESSMENT REPORT

Accompanying the document

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
amending Regulation (EU) No 909/2014 as regards settlement discipline, cross-border provision of services, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories

{COM(2022) 120 final} - {SEC(2022) 160 final} - {SWD(2022) 76 final}

Table of contents

Glossary

Term or acronym	*Meaning or definition*
Book-entry settlement	A mechanism that enables market participants to transfer assets (e.g., securities) without the physical movement of paper documents or certificates.
Buy-In	A purchase of shares by a broker after a seller has failed to deliver similar shares, the original seller being charged any difference in cost.
CMU	Capital Markets Union
Central bank money	Designates the case where a Securities Settlement System settles its cash leg on cash accounts opened in the books of a central bank.
Central counterparty (CCP)	An entity that interposes itself, in one or more markets, between the counterparties to the contracts traded, becoming the buyer to every seller and the seller to every buyer and thereby guaranteeing the performance of open contracts.
Collateral	An asset or third-party commitment that is used by the collateral provider to secure an obligation to the collateral taker. Collateral arrangements may take different legal forms; collateral may be obtained using the method of title transfer or pledge.
College of supervisors	A supervisory college is a permanent structure comprising various authorities interested in the activities of a financial participant. The framework applicable to colleges of supervisors is enshrined in the founding Regulations for the European Supervisory Authorities.
Commercial bank money	Designates the case where a Securities Settlement System settles its cash leg on cash accounts that are not opened in the books of a central bank but on the books of a banking institution.
Corporate action	A corporate action is an event initiated by a public company that brings or could bring an actual change to the securities—equity or debt—issued by the company, such as stock splits, mergers, dividend payments. The role of the CSD is to inform CSD participants holding the respective share or bond in custody about the upcoming corporate action.
Custodian or custodian bank	An entity, often a credit institution, which acts as "account provider" and provides securities custody services to its customers, i.e. holding and administration of securities owned by a third party.
CSD	Central Securities Depository. A legal person that operates a securities settlement system and provides at least a notary service or a central maintenance service.
CSDR	Regulation (EU) No 909/2014 of the European Parliament and of the Council on improving securities settlement in the EU and on central securities depositories
CPMI	The Committee on Payments and Market Infrastructures (CPMI) is an international standard setter that promotes, monitors and makes recommendations about the safety and efficiency of payment, clearing, settlement and related arrangements, thereby supporting financial stability and the wider economy. The CPMI also serves as a forum for central bank cooperation in related oversight, policy and operational matters, including the provision of central bank services.
Distributed ledger technology (DLT)	Distributed ledger is used to describe a decentralised dataset architecture which allows the keeping and sharing of records in a synchronised way, while ensuring their integrity through the use of consensus-based validation protocols and cryptographic signatures.

DVP	Delivery versus payment. A securities settlement mechanism which links a transfer of securities with a transfer of cash in a way that the delivery of securities occurs if and only if the corresponding transfer of cash occurs and vice versa.
EBA	European Banking Authority
ECB	European Central Bank
ECSDA	European Central Securities Depositories Association
EFAMA	European Fund and Asset Management Association
EEA	European Economic Area
ESCB	European System of Central Banks
ESMA	European Securities and Market Authority
Eurobond	Originally the term Eurobond was reserved to bonds that were issued in currencies different from the currency of incorporation of the issuer. Currently, Eurobonds are issued in a limited number of jurisdictions (e.g. England and Wales, US), leading to numerous situations where the law of issuance is different from the law of the issuer.
FSB	The Financial Stability Board (FSB) is an international body that monitors and makes recommendations about the global financial system. It promotes international financial stability; it does so by coordinating national financial authorities and international standard-setting bodies as they work toward developing strong regulatory, supervisory and other financial sector policies. It fosters a level playing field by encouraging coherent implementation of these policies across sectors and jurisdictions. Policies developed in the pursuit of these objectives are implemented by jurisdictions and national authorities.
ICMA	International Capital Market Association
International Central Securities Depository (ICSD)	A central securities depository (CSD) that settles domestic and international securities transactions and typically offers additional services such as securities lending and collateral management. ICSDs are usually run on direct or indirect (through correspondent banks) links to local CSDs.
IOSCO	The International Organization of Securities Commissions (IOSCO) is an association of organizations that regulate the world's securities and futures markets. Members are typically primary securities and/or futures regulators in a national jurisdiction or the main financial regulator from each country. Its mandate is to: • Develop, implement, and promote high standards of regulation to enhance investor protection and reduce systemic risk • Share information with exchanges and assist them with technical and operational issues • Establish standards toward monitoring global investment transactions across borders and markets
ISD	Intended Settlement Date. Means the date that is entered into the securities settlement system as the settlement date and on which the parties to a securities transaction agree that settlement is to take place.
Links	Direct link: an account opened by an investor CSD in the books of an issuer CSD in order to facilitate the transfer of securities from participants in the issuer CSD to participants in the investor CSD (see also Investor CSD). *Indirect link*: a link between two CSDs through a non-CSD intermediary. *Operated direct link*: a direct link between two CSDs where a third party, typically a custodian bank, operates the account in the issuer CSD on behalf of the investor CSD.

	Relayed link: a contractual and technical arrangement that allows issuer and investor CSDs to hold and transfer securities through an account with a third CSD ("middle CSD"), which acts as an intermediary. *Standard link*: a link where the investor CSD is treated as a normal participant to the issuer CSD. *Customised link*: a link where the investor CSD benefits from a special access. *Interoperable link*: A set of arrangements/procedures that allows participants in different systems to conduct and settle payment or securities transactions across systems while continuing to operate only in their own respective system. Interoperability generally works as an improvement of classical links.
Pass-on mechanism	A 'pass-on' mechanism allows each party in the transaction chain to pass-on a buy-in notification to the party failing to them, until it reaches the original fail. A single buy-in is executed by the initiating party, and the cash differentials between each original transaction and the buy-in price is settled between each of the parties in the chain.
Primary market	A section of the capital market where financial instruments, stocks and bonds, are issued/ sold/ floated for the first time by companies, governments or public institutions. After issuance these instruments are traded in the secondary market.
Security	A fungible financial instrument that holds some type of monetary value. It represents an ownership position in a publicly-traded corporation via stock (equity); a creditor relationship by owning an entity's bond; or rights to ownership represented by an option.
Securities account at the top tier level	The CSDs find themselves at the top of the securities chain, i.e. all holdings in a given financial instrument, whether by an individual or a financial institution, are ultimately kept in a securities account at the CSD.
Securities Settlement System	A system which allows the transfer of securities, either free of payment (FOP) or against payment (delivery versus payment).
Settlement	The completion of a securities transaction where it is concluded with the aim of discharging the obligations of the parties to that transaction through the transfer of cash or securities, or both.
Settlement failure	The inability of a participant to a Securities Settlement System to meet its settlement obligations in the Securities Settlement System. This inability may be temporary or permanent.
Systemic risk	The risk that the inability of one participant to meet its obligations in a system will cause other participants to be unable to meet their obligations when they become due, potentially with spill over effects (e.g. significant liquidity or credit problems) threatening the stability of or confidence in the financial system. That inability to meet obligations can be caused by operational or financial problems.
Trade repository (TR)	Trade repositories (TRs) centrally collect and maintain the records of derivatives under Regulation EU No 648/2012 (EMIR). TRs also centrally collect and maintain records of securities financing transactions (SFTs) under Regulation No 2015/2365, on transparency of securities financing transactions and of reuse and amending EMIR (SFTR).
T2S	Target2 Securities. The Eurosystem's single technical platform enabling CSDs and national central banks to provide core, borderless and neutral securities settlement services in central bank money in Europe.

1. INTRODUCTION: POLITICAL AND LEGAL CONTEXT

1.1. Introduction

Regulation (EU) No 909/2014 of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories[1] (CSDR) is one of the key regulations adopted after the 2008 financial crisis.

While central securities depositories (CSDs) were resilient, including during the 2008 financial crisis, they were not regulated consistently across the European Union (EU). This led to differences in their safety and raised level playing field concerns. Regulating CSDs was also important to complete the regulatory framework of the trading and post-trading market infrastructures, following the Market in Financial Instruments Directive (Directive 2004/39/EC[2]), which addressed trading venues, and the European Markets Infrastructure Regulation (Regulation (EU) No 648/2012[3]), which addressed central counterparties (CCPs) and trade repositories. Moreover, a consistent regulatory approach to settlement systems and settlement processes was important to complement and facilitate the Target2-Securities (T2S)[4] project launched by the Eurosystem. CSDR was also the EU's response to the call of the Financial Stability Board (FSB), on 20 October 2010,[5] for a revision and enhancement of existing standards to ensure more robust financial market infrastructures, taking into account the global standards.[6]

CSDs are financial institutions of systemic importance for financial markets, hence it is essential that their framework remains fit for purpose

CSDs play a crucial role in the primary market, by centralising the initial recording of newly issued securities ('notary service'). They operate the infrastructure ('securities settlement systems') that enables the completion of a securities transaction ('settlement'). They also maintain securities accounts that record how many securities have been issued by whom and each change in ownership ('central maintenance service'). Over EUR 53 trillion worth of securities were held in EU securities settlement systems at the end of 2019, handling over 420 million delivery instructions for a total of turnover of over EUR 1 120 trillion.[7] CSDs are essential for the financing of the economy. Apart from their role in the issuance process, securities collateral posted by companies, banks and other institutions to raise funds flows through securities settlement systems operated by CSDs.

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1 Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, OJ L 257, 28.8.2014, p. 1–72.

2 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, OJ L 145, 30.4.2004. MiFID was in force until 2 January 2018. Today, it is partly recast with MiFID2 (Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173, 12.6.2014) and partly replaced with MiFIR (Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, OJ L 173, 12.6.2014).

3 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ L 201, 27.7.2012.

4 https://www.ecb.europa.eu/paym/target/t2s/html/index.en.html.

5 https://www.fsb.org/wp-content/uploads/pr_101020.pdf.

6 https://www.bis.org/cpmi/publ/d101.htm.

7 European Central Bank Securities Holdings Statistics Database, https://sdw.ecb.europa.eu/browse.do?node=9691130 (accessed on 29.04.2021).

CSDs are also integral for the implementation of monetary policy as they settle securities in central bank monetary policy operations.

Seven years after its adoption, a review of CSDR is needed to ensure it achieves its objectives while making, where possible, the framework clearer, less costly and future proof.

CSDR has uniform requirements for the settlement of financial instruments and rules on the organisation and conduct of CSDs to promote safe, efficient and smooth settlement. Specifically, CSDR introduced: shorter settlement periods; settlement discipline measures (settlement fails reporting, mandatory cash penalties and 'buy-ins' for settlement fails); strict organisational, conduct of business and prudential requirements for CSDs; increased prudential and supervisory requirements for CSDs and other institutions providing banking services that support securities settlement; and a passport system allowing authorised CSDs to provide their services across the EU.

CSDR entered into force in September 2014; however, most of the requirements did not immediately become applicable, as CSDR empowered the Commission to adopt secondary legislation specifying the technical practicalities, leading to a phased-in schedule of certain core requirements. Certain rules, including in particular on settlement discipline, have not yet entered into force.

Article 75 of CSDR requires the Commission to review and prepare a general report on a wide range of issues by 19 September 2019. Article 81(2c) of the European Securities and Markets Authority (ESMA) Regulation[8] also requires the Commission to assess the potential supervision of third-country CSDs by ESMA. From September 2020 to August 2021, the Commission undertook an assessment of the rules in place to prepare a report. This included a targeted consultation with more than 90 contributions from a range of stakeholders, as well as reports required under Article 74 of CSDR from ESMA, in cooperation with the European Banking Authority (EBA) and national authorities.

On 1 July 2021, the Commission adopted the **CSDR review report**.[9] The report concluded that, **in broad terms, CSDR achieves its original objectives** to enhance the efficiency of settlement in the EU and the soundness of CSDs. In some areas, targeted changes could improve CSDR's efficiency and effectiveness. Other provisions have been shown to meet their objective, or changes would be premature considering the relatively recent application of requirements.

The Commission has assessed the extent to which specific policy requirements in CSDR have met their objectives in an efficient and effective way, while at the same time being coherent, relevant and providing EU added-value. This is supported by an evaluation examining the effectiveness and efficiency of CSDR in specific areas. That evaluation was performed back-to-back with the impact assessment and fed into the problem definition of the impact assessment and is presented in Annex 6.

8 Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010.

9 Report from the Commission to the European Parliament and the Council under Article 75 of Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, COM (2021) 348 final.

The evaluation indicates that **CSDR may impose in specific areas disproportionate costs and burdens and that certain requirements may be simplified to achieve its objectives more efficiently**.

The CSDR review is a **key action in the 2020 Capital Markets Union Action Plan**[10] for the development of a more efficient post-trading landscape in the EU. Resilient and efficient markets for settlement in the EU should remove barriers to cross-border settlement, ensure adequate powers to monitor risks and reduce administrative burden and compliance costs. As such, the costs of securities transactions should fall and trust in the securities transactions be enhanced, contributing to a better financing of the economy.

Finally, the consequences of **Brexit** as well as areas where the review of requirements is necessary to ensure the **return to long-term growth of the EU economy following the crisis resulting from the Covid-19 pandemic** are also considered in the analysis.

This impact assessment report concludes that **further action is necessary to address the following issues**: (1) burdensome and unclear passporting requirements; (2) insufficient coordination and cooperation between authorities; (3) restrictive requirements for the provision of banking services related to settlement; (4) complicated and unclear requirements for settlement discipline; and (5) insufficient reporting for third-country CSDs. This will ensure that CSDR's objectives are achieved in a more proportionate, efficient and effective manner. This impact assessment report considers the costs and benefits of different policy options and provides **comprehensive evidence that a reduction of costs and burdens can be achieved hand-in-hand with a simplification of CSDR, without compromising financial stability**.

1.2. Background

1.2.1. Post-trade services

A crucial element of safe and efficient capital markets is the safety and efficiency of the post-trade arrangements for securities transactions. Though largely invisible to investors, these ensure that after the trade has been carried out the buyer receives securities and the seller is paid. These services that are performed after a trade are commonly referred to as post-trade services. They typically include:[11]

- **clearing,** which guarantees performance by making the CCPs buyer to every seller and seller to every buyer;
- **settlement,** which allows the discharge of the obligation of the parties to the transaction and the transfer of cash or securities, or both;
- **asset servicing** which allows the processing and exercise of rights tied to a security over its lifetime;
- **post-trade reporting** of individual transactions and/ or positions of nominated participants.

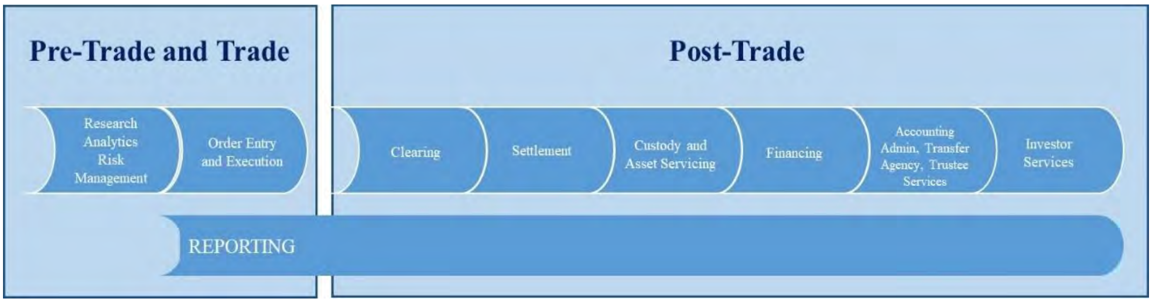
Post-trade services are an integral part of the value chain (see Figure I), as they ensure that a securities transaction is completed, including the transfer of legal ownership of a security from one party to another, and transferring cash as payment. Post-trade services

[10] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 'A Capital Markets Union for people and businesses – New Action Plan', COM (2020) 590. See Action 13.

[11] European Post-Trade Forum Report, 15 May 2017, p. 117; https://ec.europa.eu/info/publications/170515-eptf-report_en .

are provided by financial market infrastructures, i.e. Central Counterparties and CSDs, trade repositories, as well as by banks (including custodians).

Figure I[12]: Securities industries value chain



Safe and efficient post-trading systems are essential for trust in the financial system, allowing investments to flow into the real economy, increasing competition and thereby further fostering a stronger and more resilient financial system.

1.2.2. Securities settlement

CSDR defines[13] settlement as the **completion of a securities transaction after it is concluded with the aim of discharging the obligations of the parties to that transaction through the transfer of cash or securities, or both**. Timely settlement is important as it allows market participants to make contingent plans, contributing to the depth and liquidity of the financial markets and to their smooth functioning. The exchange of cash and securities is normally carried out in a Securities Settlement System (SSS) operated by a CSD. In a CSD, the buyer's and seller's transactions are matched, verifying the ability of the seller to deliver the securities and the ability of the buyer to pay; after that the transaction is settled discharging the parties from their obligations. However, if both the buyer and the seller of securities have accounts at the same bank, the transaction can also be settled by an internal transfer between those accounts. In such a case, the bank is acting as a **settlement internaliser**[14], which executes transfer orders on behalf of clients or on its own account other than through a securities settlement system.[15]

1.2.3. The role of CSDs

The **three 'core' services** under CSDR are:

- the '**settlement service**': the operation of a securities settlement system, through which securities are delivered or are exchanged between buyer and sellers;
- the '**notary service**': initial recording of securities in a book-entry system;[16]
- the '**central maintenance service**' – maintaining securities accounts at the top tier level.[17]

[12] European Post-Trade Forum Report, (see note 11), p. 117;
[13] Article 2(7) of CSDR.
[14] Article 2(11) of CSDR.
[15] A firm internalises settlement if it receives an instruction from a client and transfers securities from one securities account to another in its books rather than forward it to another intermediary or a CSD.
[16] A mechanism that enables firms to transfer assets (e.g. securities) without physically moving paper documents or certificates. Bank for International Settlement, Committee on Payments and Market Infrastructures – Glossary, https://www.bis.org/cpmi/glossary_030301.pdf .

CSDR defines[18] a CSD as a legal person that operates a securities settlement system[19] (i.e. settlement service) and provides at least one other core service (i.e. notary service or central maintenance service).

As concerns **settlement**, CSDs hold securities centrally in dematerialised form, i.e. electronically, to speed up settlement. The exchange of cash and securities is normally carried out electronically (although physical delivery is also still used if securities are held in physical form), using a procedure known as Delivery versus Payment (DvP). DvP ensures that neither party can end up with both the securities and the cash, and the other party with nothing. CSDs operating nationally will often have links with other CSDs to allow cross-border settlement and custody[20] facilities. Cross-border securities settlement is sometimes complex, involving at least two CSDs and multiple intermediaries.[21]

CSDs also play a crucial role in the **initial recording of newly issued securities (notary function)**. This generally occurs at the same time as the issuance by the issuer. These securities, once created, are usually recorded and deposited in a single CSD, the issuer CSD. This service is essential as it ensures that there are not more securities circulating than there were actually issued and entered in the account.

Finally, **CSDs ensure the maintenance of securities accounts** that record how many securities have been issued by whom and each change in who holds those securities. These securities accounts are closely linked to the key mission of CSDs, which is to ensure through their position at the top of the holding chain[22] that no more securities are settled than securities were actually issued.

CSDs also play a crucial role for the financing of the economy. Apart from the issuance process, securities collateral posted by companies, banks and other institutions flows through securities settlement systems operated by CSDs. CSDs also play an **essential role for the implementation of monetary policy by central banks** as they settle securities in central bank monetary policy operations

In addition **to their core services, some CSDs provide ancillary services**,[23] e.g. collateral management services, maintaining shareholder registers or supporting corporate actions,[24] that contribute to enhancing the safety, efficiency and transparency of securities markets, without exposing them to credit or liquidity risk. CSDR also allows CSDs to provide banking-type ancillary services[25] related to core or ancillary services, i.e. providing cash accounts and accepting deposits from participants to a securities

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17 This allows CSDs to track all holdings, i.e. who owns it, in a given financial instrument, whether by an individual or a financial institution, are ultimately kept in a securities account at the CSD (ECSDA).

18 Article 2(1) of CSDR.

19 Settlement service listed in point 3 of Annex A is the operation of a securities settlement system, through which securities are initially delivered or are subsequently exchanged between buyer and sellers (via participants to the SSS).

20 A custodian bank holds the securities on behalf of the investor and carries out instructions on their behalf.

21 “Post-trade explained – The role of post-trade services in the financial sector”, Association for Financial Markets in Europe, February 2015.

22 All tradeable securities are held on the books of various intermediaries, between the ultimate owner and the CSD, creating a security holding chain.

23 For a non-exhaustive of ancillary services provided by CSD’s list see Annex – Section B of CSDR.

24 A corporate action is an event initiated by a public company that brings or could bring an actual change to the securities—equity or debt—issued by the company, such as stock splits, mergers, dividend payments. The role of the CSD is to inform CSD participants holding the respective share or bond in custody about the upcoming corporate action.

25 For an exhaustive list see Annex – Section C of CSDR.

settlement system, providing cash credit, guarantees and commitments or payment services.

1.3. CSDs in the European Union

1.3.1. Market structure slowly evolving

Historically, CSDs were established along national lines to provide a local venue for the issuance and settlement of securities. **Today, this fragmentation remains with 26 CSDs currently authorised in the EU under Article 16 of CSDR.**[26] Nevertheless, the EU market structure is slowly evolving; end-2010 there were over 30 CSDs (including two International Central Securities Depositories (ICSDs)) operating in the EU.[27] Most recently, in March 2021, the settlement of Irish securities migrated from UK CREST[28] to Euroclear Bank Belgium. The migration, following the UK's decision to leave the EU, transferred the settlement of trading activity on Euronext Dublin to a CSD located in the EU. In contrast, the US market is more concentrated and specialised[29] with 2 CSDs.

Included in the 26 CSDs are two ICSDs: Clearstream Banking in Luxembourg and Euroclear Bank in Belgium.[30] ICSDs settle trades in international and domestic securities, usually through direct and indirect links with agents in domestic markets. Originally, ICSDs focused on settling securities transactions denominated in other currencies from where the issuer is based and CSDs focused on national markets. Today, the settlement activities of ICSDs and CSDs are more similar.[31]

CSDs operate different business models, depending on the core and ancillary services they provide. To settle trades in international and domestic currencies, ICSDs are authorised to provide ancillary banking services. The type of instruments a CSD serves does not influence its business model. **All but one EU CSD settle equities transactions and all EU CSDs settle corporate debt**. A significant majority of CSDs settle government debt.[32] **EU CSDs have a variety of corporate structures and ownership models**. Only the Croatian, Cypriot and Maltese CSDs are majority owned by the national government, while in Hungary the central bank is the majority owner. In the case of other EU CSDs shareholders include stock exchanges, banks, national governments, central banks and other private institutions.[33]

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26 ESMA CSD Register, https://www.esma.europa.eu/sites/default/files/library/esma70-155-11635_csds_register_-_art_21.pdf, ESMA70-155-11635. Nb. in addition 6 CSDs are operated by Central Banks and are exempted from the authorisation and supervision requirements under CSDR according to Article 1(4) of CSDR and one CSD is a public body charged with or intervening in the management of the public debt and is exempted from the authorisation and supervision requirements under CSDR according to Article 1(4) of CSDR.

27 Commission Staff Working Document, "Impact Assessment accompanying the proposal for a regulation on improving securities settlement in the European Union and on Central Securities Depositories (CSDs)", SWD (2012) 22 final.

28 The UK CSD operated by Euroclear UK & Ireland.

29 In the US corporate bonds and equities are cleared through the Depository Trust and Clearing Corporation (DTCC) while government securities and related entities are processed through the Federal Reserve System.

30 International CSDs were established to serve the Eurobond market – that is, bonds issued by corporate issuers for international investors, typically in a non-domestic currency.

31 See ECDA FAQ: Frequently Asked Questions - ECSDA.

32 'European CSD industry factbook, 2018 – 2019 Update', ECSDA 2020, https://ecsda.eu/wp-content/uploads/2021/01/2019_European_CSD_Industry_Factbook.pdf.

33 Ibid, Table 3: Members organised by majority shareholder type – 2019.

Although specific data for EU CSDs is not available, there are indications[34] that EU market infrastructures have enjoyed stable conditions, although less favourable than their global counterparts. Market infrastructure providers (exchanges, CCPs, CSDs) globally recovered quickly from the financial crisis with revenues growing 4% annually (2007 – 2012) and then accelerating to 10% post-crisis (2012-1017). EU providers however took longer to recover post-crisis with revenues rising only 1% over the same period.[35]

1.3.2. Size of the market

EU CSDs serve a large securities market.[36] End-2019, EU securities were traded on 430 trading venues,[37] including 135 regulated markets, 223 multilateral trading facilities and 72 organised trading facilities. As of end-2019, 28 000 equity and equity-like instruments were available for trading in the EEA, accounting for annual trading volumes of EUR 27 trillion.[38] Over 170 000 bonds were available for trading in the EEA. Annual bond trading volumes amounted to EUR 101 trillion.[39]

EU CSDs serve the growing EU capital market by handling increasing amounts of trading. In 2019, EU securities settlement systems handled more than 420 million delivery instructions worth over EUR 53 trillion of securities and representing a total turnover of over EUR 1 120 trillion.[40] In 2014, when CSDR was adopted, EUR 43.5 trillion worth of securities were held in EU securities settlement systems, which handled over 330 million delivery instructions for a total of turnover of over EUR 850 trillion. This is a growth of 22% in value of securities held, 27% in number of delivery instructions and 32% in turnover in the period between 2014 and 2019.

Despite the large number of CSDs operating in the EU, in 2019 the three[41] largest CSDs held over 60% of all securities held in EU CSDs. This is however rather a reflection of the size and liquidity of certain EU national financial markets,[42] rather than issues connected to market structure.[43]

34 Oliver Wyman, 'Global market infrastructure – How MI providers can achieve breakthrough growth', 2018.

35 Based on data for trading venues, CCPs, CSDs, inter-dealer brokers and technology providers the Europe and Middle-East Region. 'Capital market infrastructure: An industry reinventing itself', McKinsey & Company, 2017.

36 Data based on 'EU securities markets 2020', ESMA Annual Statistical Report, ESMA-50-165-1355, 18 November 2020, https://www.esma.europa.eu/press-news/esma-news/esma-publishes-first-overview-size-and-structure-eu-securities-markets.

37 A trading venue includes Regulated Markets, Multilateral Trading Facilities and Organised Trading Facilities.

38 Data based on 'EU securities markets 2020, ESMA Annual Statistical Report (see note 36), p.15 & p.24.

39 Ibid.

40 Data generated through the Securities Trading, Clearing and Settlement Statistics Database, European Central Bank, https://sdw.ecb.europa.eu/browse.do?node=9691131.

41 Euroclear Bank Belgium (28%), Clearstream Banking Frankfurt (18%), Clearstream Banking Luxembourg (15%).

42 In 2018 securities trading (debt and equity) on French, German, Italian and Spanish exchanges represented app. 88% of EU-27 total. Source: European Central Bank, Statistical Data Warehouse, Securities Trading, Clearing and Settlement, Securities Exchange – Trading Statistics.

43 In the same period, the value of securities held by the UK CSD (Euroclear UK and Ireland) rose from EUR 6 215 billion in 2015 to EUR 6 406 billion in 2019 (3% increase), while the value of delivery instructions rose from EUR 272 087 billion to EUR 357 184 billion respectively (31% increase – 'Securities trading, clearing and settlement statistics', European Central Bank, September 2020). In the US, the value of securities held by the two CSDs (DTC and Fedwire Securities Service) rose from EUR 100 739 billion in 2015 to EUR 130 366 billion in 2019 (29% increase), the number of delivery instructions processed increased from 362 663 000 (2015) to 672 887 000 (2019) (86% increase) for a

1.3.3. *Main forces driving market evolution*

In addition to regulatory changes aimed at facilitating cross-border activity, there are economies of scale and scope, driving both consolidation of different types of post-trade services and competition among EU CSDs and the different services they offer.

(a) Consolidation of the sector

First, there is a strong complementary relationship between the various components of securities settlement. Economies of scope may be achieved by integrating along the value chain of securities transaction, i.e. by combining trading, clearing and settlement into one conglomerate. Consolidation between CCPs, CSDs, and stock exchanges has created EU **financial market infrastructure conglomerates**, e.g. the formation of Clearstream through the merger of Cedel International and Deutsche Boerse in 2012. With the acquisition of the Norwegian and Danish CSDs in 2019 and 2020 respectively, Euronext has also strengthened its presence in the CSD space. This was followed in 2020 with the acquisition of Borsa Italiana (the Italian stock exchange), MTS, where most of Italy's sovereign debt is traded, as well as the major multi-asset clearing house, CC&G. Economies of scope could also be obtained through horizontal synergies. In 2009 Euroclear brought the Belgian, Dutch and French domestic CSDs onto a single platform, under a harmonised framework, but as separate legal entities. Nasdaq has also consolidated the three Baltic CSDs (Estonia, Lithuania and Latvia) in 2017 and the Icelandic CSD into a single legal entity in 2020. A number of integrated post-trade services groups operate in the EU post-trade market, i.e. Euroclear (bringing together the ICSD Euroclear Bank and national CSDs in Belgium, Finland, France, Ireland, the Netherlands, Sweden and the United Kingdom), Euronext (bringing together national CSDs in Portugal, Denmark, Norway and Italy), Deutsche Boerse (operating the ICSD Clearstream Luxembourg, the German CSD and LuxCSD) and Nasdaq CSD (following the merger of the regional CSDs for Lithuania, Latvia, Estonia and Iceland).

(b) Emerging technological innovation

The rise of new record-keeping technologies also has the potential to alter the landscape. In post-trade, distributed ledger technology[44] (DLT) is currently considered the most promising to simplify processes, reduce costs, and increase efficiency and security[45]. This will potentially lead to lower costs and faster settlement, transform how securities are held and recorded[46] and challenge incumbent settlement systems.

Most of the realised projects so far point to the potential for financial infrastructures to move towards real-time settlement, flatter structures, continuous

value of EUR 355 trillion in 2015 to EUR 401 trillion in 2019 (13% increase) (based on data from the Bank for International Settlement, Red Book Statistics, Payment and financial market infrastructures). The data shows that in 2019, there was generally increased settlement activity, explained by loose monetary conditions, low interest rates and new trading techniques.

44 Distributed ledger describes a decentralised dataset architecture which allows the keeping and sharing of records in a synchronized way, while ensuring their integrity through the use of consensus-based validation protocols and cryptographic signatures.

45 Benos, Evangelos & Garratt, Rod & Gurrola Perez, Pedro, 'The economics of distributed ledger technology for securities settlement' (2019). Ledger. 4. 10.5195/ledger.2019.144.

46 In 2015 an estimated EUR 17-24 billion was spent annually on trade processing globally; Bech, J. Hancock, T. Rice & A. Wadsworth, 'On the future of securities settlement', Bank for International Settlement, BIS Quarterly Review, March 2020.

operations and global reach.[47] This is reflected[48] in the growing application of DLT in post-trade processes, i.e. issuance and settlement of shares and bonds, data recording or the use of tokens to represent shares. Currently, applying DLT to post-trade processes has the greatest potential with respect to DvP, automation of risk management, settlement and the development of currency-substitutes as means of payment.[49]

(c) Provision of cross border services by CSDs

Fostering competition, greater interoperability and better connectivity among CSDs were some of the main policy objectives of CSDR. Nevertheless, data collected by ESMA does not reflect this.[50] EU CSDs' cross-border activity, i.e. the CSD services provided in host Member States can be measured by (1) the use of CSD links established between EU CSDs; (2) the measurement of the services provided to participants and issuers from host Member States; and (3) T2S activity.

First, a link allows a CSD to give its clients access to securities recorded and settled in another CSD. The number of links and the volumes handled by established connections measure the cross-border provision of settlement services by CSDs. In this regard, established connections are handling increasing volumes, suggesting growing cross-border activity through this channel. The value of settlement instructions settled through links with other EU CSDs increased from EUR 109 trillion in 2017 to EUR 160 trillion in 2019,[51] a growth of 47%. The total number of settlement instructions through links almost doubled between 2017 (23 278 314 instructions) and 2019 (38 984 805 instructions).[52] The growth in the use of links outpaced the growth in settlement instructions by EU CSDs (32% and 28% in 2014 and 2019 respectively).

However, the number of **CSD links**[53] has remained stable since 2017. Excluding the ICSDs which both have a very high number of links (31 for Clearstream Banking, 25 for Euroclear Bank), the average number of links per CSD is 5 links with other EU CSDs between 2017- 2020.[54] At the same time, the total number of links for all CSDs, including links with ICSDs, increased by 14% between 2017 (121 links) and 2020 (138 links). Excluding ICSDs, the number of links rose by 28% from 64 to 82 links.[55] The increasing traffic through links shows that such connections serve the development of cross-border settlement, but the limited increase of CSD links demonstrates that barriers to cross-border activities remain.

Second, another measure of use of cross-border services **are the type of CSD services, including notary and central maintenance services, provided to participants and issuers from other Member States**.

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47 Shabsigh, G., Khiaonarong, T. Leinonen H., 'Distributed ledger technology experiments in payments and settlements", International Monetary Fund, June 2020.

48 See 'The use of DLT in post-trade processes', Annex 1, Advisory Groups on Market Infrastructures for Securities and Collateral and for Payments, European Central Bank, April 2021.

49 Ibid.

50 ESMA Report to the European Commission, 'Cross-border services and handling of applications under Article 23 of CSDR', ESMA70-156-3569, 05 November 2020.

51 Ibid.

52 Ibid, para. 25.

53 According to CSDR Art. 2(1)(29) a link is "*…an arrangement between CSDs whereby one CSD becomes a* participant *in the securities settlement system of another CSD, in order to facilitate the transfer of securities from participants of the latter CSD to the participants of the former CSD, or an arrangement whereby a CSD accesses another CSD indirectly via an intermediary…*".

54 ESMA Report on cross-border services (see note 50), para. 15

55 Ibid, para 14.

In 2019, the share of central maintenance and settlement services provided to participants from other Member States by EU CSDs was 37%;[56] a slight increase compared to 2018. However, settlement activity shows that only 6 CSDs provide settlement services to more than 75% of participants from other Member States, while two-thirds of EU CSDs settle less than 50% of instructions for participants from other Member States (in value of instructions settled). A similar concentration is noted for notary and central maintenance services provided in relation to financial instruments issued by issuers from other Member States with 3 CSDs (including the two ICSDs) providing more than 80% of their services to issuers from other Member States, while most EU CSDs do not provide or dedicate less than 5% of their notary and central maintenance activity to securities issued by issuers from other Member States.[57]

Figure II: Member States in which activities of CSDs from other Member States are of substantial importance

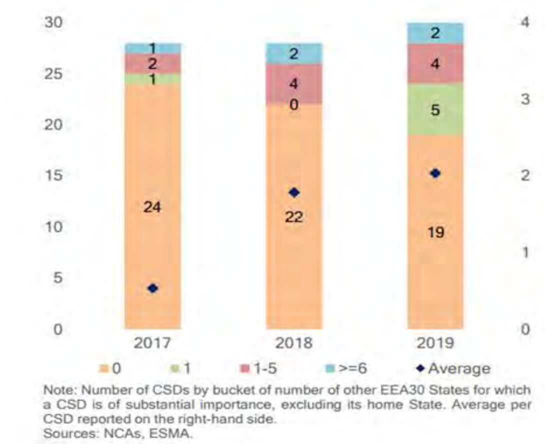
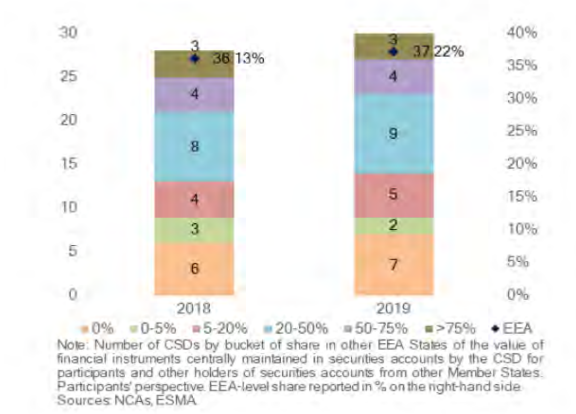


Figure III: Central maintenance services provided to participants from other Member States



Source: Report to the European Commission: cross-border services and handling of applications under Article 23 of CSDR, ESMA70-156-356, 5 November 2020, par. 40.

CSDs can provide all types of services, including of notary and central maintenance services, to participants and issuers from other Member States. In that case, a CSD may become of 'substantial importance for the functioning of the securities markets and the protection of the investors'[58] in the host Member State which allows to estimate the progression of cross border services. **There was a slight increase in the number of Member States in which the activities of CSDs from other Member States are of substantial importance** and to this date, in 19 Member States there is no substantial

[56] Of the value of financial instruments centrally maintained in securities accounts by the CSD for participants and other holders of securities accounts from other Member States.

[57] ESMA Report on cross-border services (see note 50), paras. 41 and 43.

[58] Commission Delegated Regulation (EU) 2017/389 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council as regards the parameters for the calculation of cash penalties for settlement fails and the operations of CSDs in host Member States, OJ L 65, 10.3.2017, specifies the criteria to be considered in order to determine whether a CSD is of substantial importance for the functioning of the securities markets and the protection of investors in the host Member States concerned.

activity from CSDs from other Member States (Figure II). In line with this trend, there has been a slight increase in the share of EU CSDs providing central maintenance (Figure III) and settlement services[59] to participants in other Member States.

Third, Target2-Securities (T2S), launched **in 2015**, aimed to **address fragmented securities settlement in the EU and the resulting complex cross-border settlement**. It offers delivery versus payment settlement in central bank money. It also provides harmonised and commoditised securities settlement to CSDs and applies a single set of rules, standards and prices to all participants. T2S facilitates cross-border settlement, resulting in increased integration of Europe's financial markets infrastructure by:

- simplifying the purchase of securities in other EU countries;
- reducing costs of cross-border settlement;
- increasing competition among providers of post-trade services;
- pooling collateral and liquidity;
- reducing settlement risk by using central bank money for transactions on T2S.

It connects 21 CSDs[60] from 18 Member States and Switzerland. It offers settlement in Euro and Danish Krone and processes 687 476 securities transactions worth EUR 672.53 billion per day.[61] T2S has also helped encourage harmonisation of market practices and competition in the EU.

1.4. Legal and political context

1.4.1. Legal context: Central Securities Depositories Regulation

CSDR is one of the key regulations adopted by the EU following the financial crisis of 2008 **to ensure that securities settlement is safe, stable and efficient**. It entered into force on 17 September 2014.[62]

CSDR provides a set of common requirements for CSDs across the EU by introducing:

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

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[59] See para 41, ESMA Report on cross-border services, ESMA70-156-3569, 05 November 2020.

[60] In case of Belgium (Euroclear Belgium and National Bank of Belgium Securities Settlement System) and France (Euroclear France and ID2S) more than one CSD participates to T2S. For a list of CSDs participating to T2S see: https://www.ecb.europa.eu/paym/target/t2s/profuse/shared/pdf/List_of_CSDs_connected_to_T2S.pdf.

[61] Eurosystem T2S Annual Report 2020.

[62] CSDR was incorporated in the EEA Agreement with Council Decision (EU) 2019/134 of 21 January 2019 on the position to be adopted, on behalf of the European Union, within the EEA Joint Committee, concerning the amendment of Annex IX (Financial Services) to the EEA Agreement, OJ L 25, 29.1.2019.

The CSDR legal framework also includes Level 2[63] and Level 3 measures (e.g. ESMA guidelines and Q&As).

CSDs **may also be subject to other EU legislation** depending on their status, e.g. CSDs operating with a banking license are also subject to the relevant banking legislation. Moreover, they may have to comply with certain national laws in the Member State in which they are incorporated, e.g. securities, corporate or civil law. As securities settlement systems, CSDs qualify as systems under the Settlement Finality Directive[64] and are therefore subject to the applicable national transposing laws.

Finally, CSDs should also consider the International Principles for financial market infrastructures[65] issued by the Committee on Payments and Market Infrastructures (CPMI)[66], the International Organization of Securities Commissions (IOSCO)[67] and the FSB[68].

1.4.2. Political context: Capital Markets Union (CMU), Brexit, Recovery post Covid-19

The Commission launched its follow-up CMU Action Plan to create a single market for capital across the EU. The aim is to increase investment and savings flowing throughout the EU, benefitting citizens, investors and companies, regardless of where they are located. A fully functioning and integrated market for capital will allow the EU economy to grow in a sustainable way and be more competitive.

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63 Commission Delegated Regulation (EU) 2017/389 (see note 58); Commission Delegated Regulation (EU) 2017/390 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on certain prudential requirements for central securities depositories and designated credit institutions offering banking-type ancillary services, OJ L 65, 10.3.2017; Commission Delegated Regulation (EU) 2017/392 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on authorisation, supervisory and operational requirements for central securities depositories, OJ L 65, 10.3.2017, Commission Implementing Regulation (EU) 2017/394 of 11 November 2016 laying down implementing technical standards with regard to standard forms, templates and procedures for authorisation, review and evaluation of central securities depositories, for the cooperation between authorities of the home Member State and the host Member State, for the consultation of authorities involved in the authorisation to provide banking-type ancillary services, for access involving central securities depositories, and with regard to the format of the records to be maintained by central securities depositories in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council, OJ L 65, 10.3.2017; Commission Delegated Regulation (EU) 2018/1229 of 25 May 2018 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline, OJ L 230, 13.9.2018, ('RTS on settlement discipline'); Commission Delegated Regulation (EU) 2017/391 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards further specifying the content of the reporting on internalised settlements, OJ L 65, 10.3.2017; Commission Implementing Regulation (EU) 2017/393 of 11 November 2016 laying down implementing technical standards with regard to the templates and procedures for the reporting and transmission of information on internalised settlements in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council, OJ L 65, 10.3.2017.

64 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, OJ L 166, 11.6.1998.

65 https://www.iosco.org/about/?subsection=cpmi_iosco.

66 Committee on Payments and Market Infrastructures (CPMI) of the BIS sets international standards to promote, monitor and recommend about safety and efficiency of payment, clearing, settlement and related arrangements. See: https://www.bis.org/cpmi/about/overview.htm .

67 International Organization of Securities Commissions (IOSCO) is an association of organizations that regulate the world's securities and futures markets. See: https://www.iosco.org

68 Financial Stability Board (FSB) is an international body, operating in the framework of the G20, that monitors and makes recommendations about the global financial system. See: https://www.fsb.org/about/

The **2020 CMU Action Plan**[69] and the **2021 Commission Work Programme** announced the Commission's intention to come forward with a legislative proposal to amend CSDR to improve its efficiency and effectiveness (CSDR REFIT) and contribute to the development of a more efficient post-trading landscape in the EU. This follows from the work of the High Level Forum for the CMU[70] that, amongst others, made recommendations to facilitate the emergence of a common EU CSD market. Resilient and efficient markets for settlement in the EU should remove barriers to cross-border settlement, ensure adequate powers to monitor risks and reduce administrative burden and compliance costs. As such, costs of securities transactions should fall, and trust in securities transactions rise, contributing to a better financing of the economy.

More generally, any forthcoming EU legislative proposal, including on CSDR, will have to take into account, where necessary, **the consequences of Brexit as well as to identify how to contribute to the return to long-term growth of the EU following the crisis resulting from the Covid-19 pandemic and to finance the EU's environmental and digital transitions**.

Regarding Brexit, on 25 November 2020, the Commission adopted an equivalence decision determining that, until 30 June 2021, the regulatory and supervisory framework applicable to CSDs established in the UK is equivalent in accordance with CSDR. On 11 December 2020,[71] ESMA announced that Euroclear UK & Ireland Limited, the UK CSD, would be recognised as a third-country CSD. **ESMA's recognition decision applied from 1 January until 30 June 2021**. The aim was to give EU issuers, and in particular Irish issuers that used that CSD, sufficient time to transfer their securities to an EU CSD, a project which was completed on 15 March 2021.[72] From its side, the UK introduced a **transitional regime[73]** under which certain non-UK CSDs can offer CSD services until they are permanently recognised under the UK CSDR. As of 30 April 2021, 15 non-UK CSDs that have notified the Bank of England that they will offer CSD services in the UK under the transitional regime.[74] In addition, the UK Treasury[75] announced that the UK **will not implement the CSDR settlement discipline regime.**

As concerns the Covid-19 crisis, post-trade infrastructures, and CSDs in particular, have remained resilient and continue to provide their services. Nevertheless, due to the impact of the Covid-19 pandemic on the implementation of regulatory projects and IT deliveries by CSDs and their participants, ESMA proposed postponing the date of entry into force

[69] Commission Communication 'A Capital Markets Union for people and businesses – New Action Plan' (see note 10).

[70] Final report of the High Level Forum on the Capital Markets Union - A new vision for Europe's capital markets |European Commission (europa.eu): https://ec.europa.eu/info/files/200610-cmu-high-level-forum-final-report_en.

[71] ESMA to recognise Euroclear UK & Ireland Limited (EUI) after Brexit transition period (europa.eu) https://www.esma.europa.eu/press-news/esma-news/esma-recognise-euroclear-uk-ireland-limited-eui-after-brexit-transition-period.

[72] Successful migration of Issuer CSD Services for Irish Securities from Euroclear UK & Ireland to Euroclear Bank - Euroclear: https://www.euroclear.com/newsandinsights/en/press/2021/2021-mr-07-irish-securities-migration.html.

[73] As the Settlement Finality Directive is closely linked to CSDR, it is worth noting that the UK also allows certain EEA systems to receive temporary UK settlement finality protection under the temporary designation regime of the Financial Markets and Insolvency until they receive 'steady state' designation.

[74] List of third-country CSDs (bankofengland.co.uk), https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/financial-market-infrastructure-supervision/list-of-third-country-csds.pdf?la=en&hash=824459A062CBB16DD1C8A42AD2D99A9DC36E3E31.

[75] Written statements - Written questions, answers and statements - UK Parliament, https://questions-statements.parliament.uk/written-statements/detail/2020-06-23/HCWS309 .

of the Regulatory Technical Standards (RTS) on settlement discipline[76] until 1 February 2022.[77] Stakeholders also noted that market developments during this crisis would have been significantly worse in terms of available market liquidity if the settlement discipline was in place. In this regard, **the European Parliament, in its resolution on further development of the Capital Markets Union,**[78] also invited the Commission to review the settlement discipline regime under CSDR in view of Brexit and the Covid-19 crisis.

Finally, market infrastructures were also part of two recent packages published by the Commission on **digital finance**[79] and on **fostering openness, strength and resilience of the European economic and financial system**.[80] **In September 2020**, in line with the Commission priorities to make Europe fit for the digital age and to build a future-ready economy that works for people, the Commission published a New Digital Finance Package,[81] which included a legislative proposal on a pilot regime[82]. This **proposal seeks to collect experience and to provide legal certainty and flexibility for market participants (including CSDs) who wish to operate a DLT market infrastructure,** by establishing uniform requirements for operating these DLT systems. Under this pilot regime trading facilities and CSDs using DLT can develop their businesses and provide a safe environment for market participants and investors. To this end, it provides optional exemptions to certain requirements of CSDR. The New Digital Finance Package also includes a 'Digital Operational Resilience Act' (DORA)[83] that aims to ensure that all participants in the financial system, including CSDs, have the necessary safeguards in place to mitigate cyber-attacks and other risks.

Furthermore, in January 2021, as part of a broader set of actions to strengthen the EU's open strategic autonomy and resilience, the Commission published a communication on '**The European economic and financial system: fostering openness, strength and resilience**.[84] This Communication sets out how the EU can reinforce its open strategic autonomy in the macroeconomic and financial fields by, inter alia, further developing EU financial market infrastructures, including CSDs, and increasing their resilience.

In conclusion, this REFIT initiative should be viewed within the context of the broader agenda to make the EU markets more competitive, digital and resilient as represented by the CMU, digital and open strategic autonomy initiatives. **However, developing internationally competitive CSDs is not a direct objective of CSDR per se. The main objectives of CSDR and this Review are to allow EU settlement markets to become more efficient and secure. However, market players will benefit from efficient and**

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76 RTS on settlement discipline (see note 63).

77 ESMA proposes to further postpone CSDR settlement discipline, https://www.esma.europa.eu/press-news/esma-news/esma-proposes-further-postpone-csdr-settlement-discipline.

78 European Parliament Resolution of 8 October 2020 on further development of the Capital Markets Union (CMU), (2020/2036,(INI)), see para. 21.

79 https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en.

80 Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, 'The European economic and financial system: fostering openness, strength and resilience', COM/2021/32.

81 https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en.

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

83 Proposal for a Regulation of the European Parliament and of the Council on digital operational resilience for the financial sector and amending Regulations (EC) No 1060/2009, (EU) No 648/2012, (EU) No 600/2014 and (EU) No 909/2014, COM(2020) 595.

84 Commission Communication, 'The European economic and financial system: fostering openness, strength and resilience' (see note 80).

reliable settlement as well as increased competition in the EU capital market. This may drive the emergence of internationally competitive EU post-trade service providers.

1.4.3. Stakeholder consultation

Stakeholder consultation took different forms (see Annex 3), including:

- a Commission targeted consultation between 8 December 2020 and 2 February 2021[85];
- ESMA reports - four reports in 2020 and 2021 were submitted to the Commission on internalised settlement,[86] the cross-border provision of services by CSDs and the handling of applications to provide notary and central maintenance services cross-border,[87] the provision of banking type ancillary services[88] and the use of FinTech by CSDs.[89] Such reports also took into account answers to ESMA surveys from national authorities, CSDs and participants;
- Meetings with Member States' Experts, where the secretariat of the Economic and Monetary Affairs committee of the European Parliament, the ECB and ESMA were also invited, on 22 September 2020 and 15 July 2021;
- Input from the European System of Central Banks (ESCB) to the CSDR consultation process, including an anonymised and consolidated outcome of a survey conducted among CSDs.
- A meeting with Members of the European Parliament on 6 September 2021;
- Bilateral meetings with stakeholders as well as confidential information received from a wide range of stakeholders.

1.4.4. Report to the Council and the Parliament

Article 75 of CSDR required the Commission t**o review and prepare a general report on the Regulation** and submit it to the Parliament and the Council by 19 September 2019. Furthermore, Article 81(2c) of Regulation (EU) 2010/10 establishing a European Supervisory Authority (European Securities and Markets Authority), required the Commission, after consulting all relevant authorities and stakeholders, **to conduct a comprehensive assessment of the potential supervision of third-country CSDs by ESMA** exploring certain aspects, including recognition based on systemic importance, ongoing compliance, fines and periodic penalty payments.

Taking into account that some CSDR requirements did not apply until the entry into force of the relevant regulatory technical standards in March 2017 and that some EU CSDs were only recently authorised under CSDR, the Commission report on CSDR was adopted in July 2021.[90] The report identifies specific areas where targeted action may be

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85 Commission targeted consultation on the review of regulation on improving securities settlement in the European Union and on central securities depositories, https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en.

86 ESMA Report to the European Commission, 'CSDR Internalised Settlement', 5 November 2020, ESMA70-156-3729.

87 ESMA Report on cross-border services (see note 50).

88 ESMA Report to the European Commission, 'Provision of banking-type ancillary services under CSDR', 08 July 2021, ESMA70-156-4582.

89 ESMA Report to the European Commission, 'Use of FinTech by CSDs', 2 August 2021, ESMA70-156-4576.

90 Report from the Commission to the European Parliament and the Council under Article 75 of Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities

necessary to ensure the fulfilment of the objectives of CSDR in a more proportionate, efficient and effective manner. The five main areas identified are the following:

- clarifying and simplifying the burdensome requirements related to the provision of services by CSDs domestically and cross-border;
- improving the supervisory convergence amongst authorities involved in CSDs' supervision;
- facilitating the provision of banking-type ancillary services;
- reducing the disproportionate burdens and costs related to settlement discipline;
- enhancing the framework for third-country CSDs.

In its report, the Commission also invited ESMA to consider whether supervisory convergence tools could be used or amendments to existing regulatory technical standards may be required to facilitate the use of technological innovation by CSDs.

2. PROBLEM DEFINITION

2.1. Methodology

The main problems assessed in this impact assessment concern areas for which an evaluation has been carried[91] out, as well as input received from various authorities and stakeholders (see section 1.4.3). These indicate that targeted action is necessary to ensure fulfilment of the CSDR objectives more proportionately, efficiently and effectively.

The impact assessment considers the costs and benefits of targeted amendments to CSDR concerning the barriers to cross-border settlement, the disproportionate compliance costs and the insufficient insight into the activities of third-country CSDs. While the definition of the problems is targeted, the impact assessment considers the cumulative impact of targeted changes as presented in section 8.

A key consideration is that the application of CSDR remains work in progress. A sufficient number of EU CSDs was authorised only recently under CSDR, the regulatory technical standards specifying CSDR started applying only as of 2017 and certain core CSDR requirements (including settlement discipline) are yet to enter into application. This limits the availability of data on costs and benefits of the requirements.

First, while the full impact of CSDR is still unfolding, feedback from stakeholders and public authorities[92] indicates that CSDR has contributed to achieving its original objectives of ensuring safety of settlement and financial stability. The impact assessment therefore only considers targeted changes at this point in time.

Second, certain issues raised by authorities and stakeholders are not covered in this impact assessment, because they cannot or should not at present be addressed within the context of CSDR, e.g.:

a) stakeholders noted that CSDs are still subject to Member States' **national laws for issues not regulated in CSDR**, such as corporate or civil law matters. This

settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, COM(2021) 348.

91 See Annex 6.

92 See Summary report of the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories ('Summary report of the Commission CSDR targeted consultation'), https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2020-csdr-review-summary-of-responses_en.pdf.

may impact their ability to offer services cross-border as they may need to set up separate operational processes and procedures to comply with the relevant host Member States' requirements. Nonetheless, harmonisation of the relevant national laws goes beyond the scope of CSDR and therefore is not considered.

b) stakeholders, including the High Level Forum on the CMU, raised concerns about **CSDs' access to central bank money**[93] which is subject to conditions set by the central bank in question; e.g. in the Euro area, the ECB sets the access conditions.[94] For CSDs that want to settle in central bank money in a currency other than that of the jurisdiction of their authorisation (or outside of the EU), access to the respective central banks can be challenging[95] and therefore limited. Indeed, very few EU CSDs seem to have direct access to foreign central banks; e.g. one EU CSD has locally incorporated licensed subsidiaries to obtain access to some foreign central banks (e.g. Australian, Canadian, US), however access to others remains impossible (e.g. Russia).[96] This is particularly an issue for smaller CSDs, due to the cost and significant time the process requires. Nonetheless, due to the principle of central bank independence, CSDR cannot introduce obligations on central banks to facilitate CSDs' access to central bank money within the EU.

c) digitalisation and new technologies are transforming the EU financial system and the way it provides financial services to EU businesses and citizens. **This raised questions of whether existing CSDR provisions ensure technology neutrality.**[97] The Regulation for pilot regime for market infrastructures based on DLT (see section 1.4.2), which allows DLT entities to be exempted under certain conditions from complying with certain CSDR provisions, should enable all stakeholders to gain insights into the use of DLT for market infrastructures and the legislation to adapt to the gathered experiences. It therefore seems that any fundamental changes to CSDR to realise the full potential of technology should be postponed until the lessons can be drawn from the pilot regime's implementation. This is a view that most respondents to the targeted consultation, as well as ESMA, share. Fintech, which is an area related to the existing CSDR framework, is therefore outside of the scope of this impact assessment.

d) **Processes for withholding tax** are a barrier for efficient EEA market infrastructures and for cross-border settlement. It was identified in the first Giovannini Report[98] and reconfirmed in the 2020 CMU Action Plan.[99] However,

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93 A securities trade typically results in an obligation for the seller to deliver securities and a corresponding obligation for the buyer to deliver cash. In principle, to deliver cash, CSDR promotes settlement in central bank money. Settling in central bank money meant the risk of the cash part of a securities transaction is settled in a central bank account. This offers more security than commercial banks in terms of continuity of the payment services as well as the availability of liquidity. When settlement in central bank money is not practical or available, CSDR allows settlement under commercial bank money under strict conditions (on settlement in commercial bank money see section 2.3.3).

94 See https://www.ecb.europa.eu/paym/coll/coll/html/SSS_links_eligibility.en.html.

95 European Post-Trade Forum Report (see note 11), p. 116; remote participation is not always allowed and most CSDs are not authorised as banks.

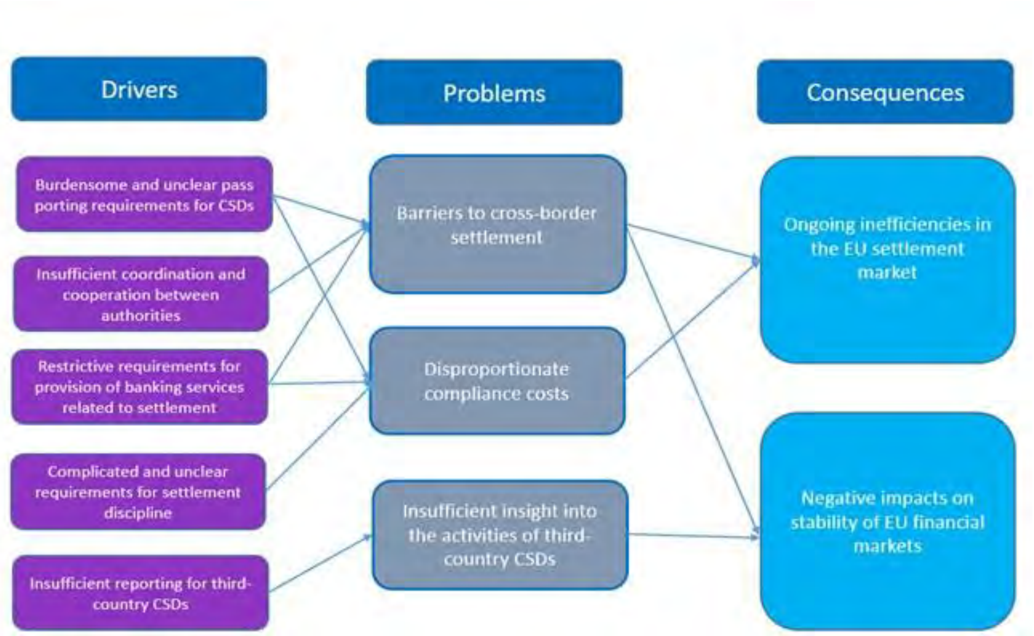
96 ESMA Report 'Provision of banking-type ancillary services under CSDR' (see note 88), p. 16.

97 The technology neutrality principle means that legislation or policy should not prescribe technological solutions on businesses, citizens or other stakeholders. Any product or service should be accessible through any means, platform or operating system.

98 Cross-border clearing and settlement arrangements in the European Union - Giovannini Group – 22 November 2001**:** Giovannini reports, https://ec.europa.eu/info/publications/giovannini-reports_en .

as taxation aspects cannot be dealt with in CSDR, and as the Commission plans to propose a legislative initiative for introducing a common, standardised, EU wide system for withholding tax relief at source, accompanied by an exchange of information and cooperation mechanism among tax administrations, this issue is outside the scope of this impact assessment.

2.2. What are the problems?



For a detailed description of the identified problem areas see Annex 6.

2.2.1. Barriers to cross-border settlement

One of the main objectives of CSDR was to facilitate cross-border settlement in order to limit the risks and costs involved. Nevertheless, most stakeholders see limited progress in the provision of cross-border services by CSDs (see point (c) in Section 1.3.3).[100] The evaluation,[101] has identified three main reasons for this: (i) burdensome passporting process; (ii) insufficient cooperation between authorities; and (iii) restrictive requirements for the provision of banking services related to settlement.

First, the **passporting process** (i.e. the special procedure under which a CSD authorised in a Member State can provide services in relation to financial instruments constituted under the law of another Member State), is **burdensome**. It requires, where relevant, the agreement of the host national supervisor, regarding the assessment by the CSD of the measures it intends to take to allow its users to comply with the national law referred to in Article 49(1). This partially shifted the burden from the participants to CSDs by requiring the latter to demonstrate that they have the relevant measures in place, rather

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[99] Commission Communication, 'A Capital Markets Union for people and businesses - New Action Plan' (see note 10), see Action 10.

[100] ESMA Report on cross-border services (see note 50), p. 20.

[101] See "Annex 5 – Evaluation" and ESMA Report 'Provision of banking-type ancillary services under CSDR' (see note 88).

than relying on users to directly ensure that the CSD they use allows them to comply with the applicable national legislation, despite the fact that it is the users' responsibility to comply with such national legislation. The objective was to ensure that the provision of cross-border services by a CSD would not affect the application of relevant national laws. The unintended consequence was to make the passporting process burdensome[102], thereby deterring CSDs from expanding their activities across borders (see sections 1.3.3, 2.2.1 and 2.3.1) or leading others to stop providing cross-border services. The fact that so far there have been no refusals by host national supervisors shows that although passporting is not used as tool to protect national markets, it has added a burdensome and costly level of complexity. Simultaneously, certain third-country CSDs seem to be exempted from these requirements (See section 2.3.5), making **it is easier for them to operate cross-border in the EU than for an EU CSD**.

Second, **cooperation between authorities in home and host Member States and supervisory convergence is insufficient** (see section 2.3.2). Despite the existence of provisions enabling the use of cooperative arrangements or voluntary supervisory colleges, **there is no evidence of their extensive use** (only one college of supervisors has been set up and no information is available to ESMA on whether the other required cooperative arrangements under CSDR have been set up). This means that the same CSD is likely to be subject to different supervisory arrangements and requirements depending on the Member States of operation (see also section 2.3.2).

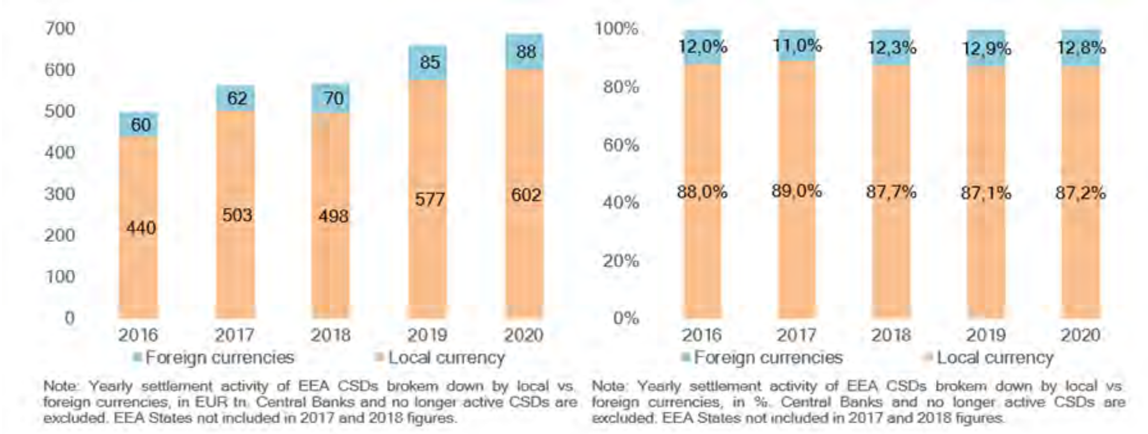
Third, CSDR contains **strict conditions for CSDs to settle a transaction in commercial bank money** (see section 2.3.3). A securities trade typically results in an obligation for the seller to deliver securities (securities leg) and a corresponding obligation for the buyer to deliver cash (cash leg). To ensure delivery of the cash, a CSD may use accounts at a central bank[103] or commercial bank (i.e. CSDs may open accounts in their own books or in a commercial bank). Access to central banks depends on the respective central bank, brings cost and therefore requires economies of scale. Consequently, settlement in commercial bank money is sometimes the only option available for CSDs that want to settle in currencies other than that of the jurisdiction in which they are authorised (e.g. because the CSD does not have an account with the central bank of the transaction's currency). However due to the restrictive nature of the conditions, the **percentage of EEA CSDs' settlement activity in foreign currencies** (Figure V) **and the level of settlement in foreign currencies remains limited**. [104]

Figure V: Settlement in foreign currencies by EEA CSDs

[102] Summary report of the Commission CSDR targeted consultation (see note 92).

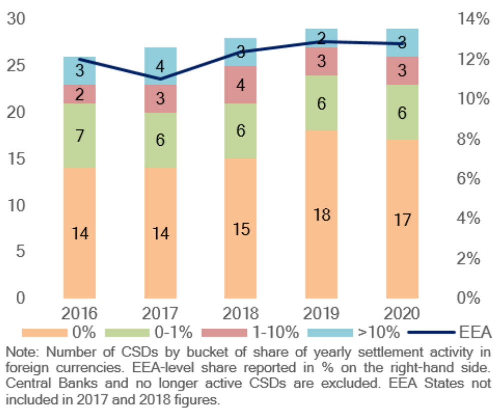
[103] CSDR, in line with international standards, gives preference to settlement in central bank money as a credit balance at a central bank implies no credit risk since what defines a central bank is its absolute ability to issue currency to meet its needs. CSDs in the EU in principle have access to the central bank of the currency in their jurisdiction and can therefore settle trades in that currency in central bank money.

[104] As central banks can set their own access criteria, such as an obligation to be established in the jurisdiction of the relevant currency, this is even more pertinent for EEA CSDs considering activities outside the EEA.



Furthermore, as seen in Figure VI, **the vast majority of CSDs settle in only one or two foreign currencies.**[105] This means that issuers have a **limited choice for multicurrency issuance** which prevents genuine cross-border competition (especially since issuers seek one-stop-shop solutions)[106] and the emergence of a single capital market.

Figure VI: Number of CSDs per range of yearly settlement in foreign currencies[107]



2.2.2. Disproportionate compliance costs

Market participants and authorities have identified targeted areas where the CSDR compliance costs are disproportionate, because (a) legal requirements are unclear, and/or (b) they are considered excessively burdensome, and/or (c) the costs of complying with the rules appear to outweigh the potential benefits. Three areas have been identified as generating disproportionate compliance costs: passporting rules; rules on the provision of banking services related to settlement; and the settlement discipline regime.

First, the CSDR passporting rules allow CSDs to provide services for financial instruments constituted under the law of any Members State, thus allowing **CSDs to benefit from access to a larger market** and issuers to have more choice in where they issue and hold their securities. However, the associated **the legal requirements have turned out to be unclear and burdensome** (see section 2.3.1).

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[105] ESMA Report 'Provision of banking-type ancillary services under CSDR' (see note 88).

[106] Euronext response to the Commission targeted consultation on CSDR: https://www.euronext.com/it/regulation/government-affairs.

[107] Report to the European Commission: provision of banking-type ancillary services under CSDR, ESMA, 8 July 2021: esma70-156-4582_report_to_the_ec_-_csdr_banking_services.pdf (europa.eu).

In addition, the objective difficulty to comply with the legal requirements and the subsequent threat of potential legal action, generate costs that present an unnecessary barrier to the development of CSD activities. A CSD reported confidentially[108] that the associated internal legal support required throughout the passporting process was significant[109]. Even if most CSDs applying for a passport to operate cross-border have been able to obtain it, stakeholders have indicated that this process is difficult, lengthy and demanding (see section 2.3.1).

Second, the rules around the provision of banking services create disproportionate compliance costs for CSDs. This negatively impacts the provision of cross-border services. The lack of alternatives to settle in commercial or central bank money could undermine the safety of settlement, as transactions could be settled free of payment instead of delivery versus payment, increasing risks for the market as a whole.[110] For a detailed explanation of specific problems faced and/ or risks created by CDS settling in commercial bank money see Annex 6.

Third, certain elements of settlement discipline,[111] although not yet applicable, would potentially create disproportionate compliance costs for CSDs and market participants. To ensure the safety of settlement, any participant in a securities settlement system should settle its obligation on the intended settlement date (ISD); a settlement fail occurs when a transaction does not settle on that date.[112] The settlement discipline regime aims to encourage market participants to avoid settlement fails; its **two main elements** are the measures to prevent settlement fails (Article 6 of CSDR) and the measures to address settlement fails (Article 7 of CSDR). The latter comprise two main pillars; cash penalties and mandatory buy-ins. CSDs would be required to impose **cash penalties** on their participants in case of settlement fails. If despite the cash penalties, the original seller fails to deliver the securities, it will be subject to **a mandatory buy-in**. A buy-in provides the buyer of securities with the right to buy the securities elsewhere, cancel the original transaction and put the costs of the buy-in, as well as any price difference, with the original seller.[113]

The original objective of the settlement discipline regime as contained in the 2012 Commission proposal[114] was mainly to harmonise the diverse market discipline measures across EU capital markets. Hence the proposed measures were general, with detailed technical standards to be set in secondary legislation[115]. The impact assessment could not quantify *ex ante* the costs and benefits of these general settlement discipline measures relying rather on qualitative assessments. The final set-up of the settlement discipline regime and the associated costs and benefits, became evident to the market participants only when the 2018 regulatory technical standard[116] (RTS) was published. Furthermore,

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[108] Based on confidential information provided to DG FISMA services.

[109] Information provided to DG FISMA services confidentially. In addition to the internal legal support, it is in practice impossible to provide a formalised assessment per market and per type of securities in all EEA countries without external legal advice.

[110] European Post-Trade Forum Report (see note 11), p. 117.

[111] Articles 6 and 7 of CSDR.

[112] CSDR defines settlement fails as the non-occurrence of settlement, or partial settlement of a securities transaction on the intended settlement date, due to the lack of securities or cash and regardless of the underlying cause (Article 2(15) of CSDR).

[113] More details regarding the buy-in process is included in Annex 9.

[114] COM (2012) 73 final.

[115] See the Impact Assessment supporting the 2012 CSDR proposal. See SWD92012) 22 final, Option 1.1.2: Introduce common EU principles for settlement discipline

[116] Commission Delegated Regulation (EU) 2018/1229.

market volatility of spring 2020 triggered reflections about the potential impact of the regime on trading conditions or ability to fulfil certain market functions.

Although settlement discipline rules would incentivise improvements in settlement rates, it would also create high one-off (i.e. connecting to buy-in agents, repapering existing contracts to take account of mandatory buy-in rules) and ongoing costs (i.e. in terms of pricing and reduced liquidity of instruments potentially at risk of being bought-in or trades being abandoned or migrating to non-EU trading venues (see section 2.3.4)).

Evidence provided seems to show that these costs are disproportionate and would stem both from the **lack of clarity around the rules governing the process** (i.e. what transactions are in-scope or how to use buy-in agents), from the **framework's impact on market conditions** (deterioration of liquidity for some instruments, higher bid-ask spreads) and **market participants' trading behaviour** (migration of trading from peripheral instruments to liquid instruments, doubts around the viability of the market maker role for less liquid instruments). The costs of applying **in particular the rules on mandatory buy-in** could outweigh their benefits **for three main reasons:**

First, the market volatility of March/April 2020 gave stakeholders the opportunity to reflect on how the upcoming settlement discipline regime would have impacted the market.[117] In essence, mandatory buy-ins could have exacerbated the negative impacts linked to the crisis; **in particular they could have increased liquidity pressure and increased the costs of securities at risk of being bought-in.**[118]

This would affect negatively market makers that take on risk onto their balance sheet to provide immediate execution to clients. They[119] are an important source of liquidity and often offer securities they do not hold,[120] based on the reasonable assumption of sourcing these securities when necessary. For securities not held on their balance sheet, or which cannot be readily sourced, the introduction of mandatory buy-ins would impact the ability of market makers to make markets. To adjust for the expected cost of being bought-in, market makers will have to add a premium to their prices – which will widen the bid-offer spread (which will in turn increase costs to end-investors) – or they may simply not make an offer price on an enquiry thereby deteriorating market liquidity.

Although these liquidity effects are most pronounced in choices made by market makers, all investors, even in liquid securities, could face similar trade-offs between entering into a trade (providing liquidity), the availability of the instrument and the cost of being bought-in. These impacts are likely to be reflected in behavioural change, rather than a price adjustment.[121]

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117 Summary Report of the Commission CSDR targeted consultation (see note 92).

118 More than half of respondents to the targeted consultation, all categories included, considered that the CSDR settlement discipline regime would have had a significant negative impact on the market if it had been in place during the market turmoil provoked by Covid-19. Summary Report of the Commission CSDR targeted consultation (see note 92).

119 By providing a buy and sell price for securities (bid-ask spread) market makers establish liquidity and pricing, and help end-investors to redeem funds or transact in a timely fashion in instruments for which there may not be a counterparty with an immediate opposite intention.

120 Market makers aim to run low levels of inventory since high levels of inventories have high risk, capital and funding costs.

121 Especially during a credit crunch, this effect could be amplified as lenders would want to have the ability to sell holdings at short notice to raise cash liquidity and the amount they will be willing to lend will be further reduced.

Periods of market stress could be exacerbated by mandatory buy-ins as participants would have to buy back the securities that already had limited availability **adding further liquidity pressure.**[122] Investors would have chased a small number of available securities, **driving up prices** and potentially, **further driving volatility in a stressed market**. Evidence provided by one bank, showed that the application of mandatory buy-ins to EU government bonds in the current liquidity context **could have led to a 50%-100% increase in bid-offer spreads**.[123]

Second, the settlement discipline regime could also give rise to unintended consequences for the competitiveness of the EU capital markets. Capital markets outside the EU do not have a comparable settlement discipline regime.[124] These markets rather rely on industry-led measures[125], i.e. the UK announced it is not implementing the CSDR settlement discipline regime and will rely on settlement rules set by CREST, the UK-based CSD.[126] In particular mandatory buy-ins may create an additional cost and risk for EU-settled securities that could disadvantage EU companies. Wider spreads and less liquidity will reduce the investment returns of pension funds, asset managers and, ultimately, end investors, which, according to some stakeholders, could risk driving issuance, trading and investment activity outside of the EU.[127] Furthermore, application of mandatory buy-ins could lead to a potentially loss of counterparties and liquidity for the EU capital market.[128] The potential negative impact on the attractiveness of the EU market would be at odds with the objectives making the EU capital market more attractive by increasing the safety of settlement.

Finally, against the above arguments, it should be noted that despite the dramatic increase in trading (settlement instructions increased by 30% between 2015 – 2019 in EU

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[122] Based on responses to the Commission CSDR targeted consultation from AFME, Association of German Banks, European Fund and Asset Management Association (EFAMA), et al.

[123] Based on confidential information provided to DG FISMA services.

[124] During the CSDR consultation process stakeholders referred to SHO Regulation and SEC Rule 204, which however relates only to short-selling and the obligation that broker and dealer must close-out unresolved equities transactions. This was introduced to discourage the market from naked short-selling. Also examples of buy-in were given for Asian markets, in particular Singapore Exchange where any unsettled buy-in trade is carried forward to the next business day for settlement. If the buy-in and procurement remains unsuccessful by ISD +6, cash settlement will be initiated against the seller to provide resolution of the sale trade. However the Singapore Exchange has a very low failure rate because of DvP and very few trades go to buy-in.

[125] For instance, the International Capital Markets Association (ICMA) provides voluntary buy-in and sell-out rules that allow non-defaulting parties the right to enforce physical settlement of failed trades without incurring any direct losses, while the Global Master Repurchase Agreement allows non-defaulting parties to remedy failed repo transactions. These tools are voluntary and application is subject to contractual agreements between trading parties. "How to survive in a mandatory buy-in world?", ICMA, June 2018.

[126] Written statement by Chancellor of the Exchequer on 23 June 2020, https://questions-statements.parliament.uk/written-statements/detail/2020-06-23/HCWS309. In the meantime the UK will continue to apply CREST settlement discipline rules on failed transactions (p.37): https://www.crh.com/media/3376/crest-rules-january-2021.pdf It provides for fines on either failed bought or sold transactions.

[127] See AFME response to the Commission CSDR targeted consultation, p. 36, https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME_CSDR_CP_Response_Final.pdf.

[128] 'Who Owns the European Economy? Evolution of the Ownership of EU-Listed Companies between 1970 and 2012', The European Savings Institute & INSEAD OEE Data Services, 2013, https://ec.europa.eu/info/sites/default/files/file_import/1308-report-who-owns-european-economy_en_0.pdf.

CSDs[129]) **the settlement fail rate has remained relatively stable in the EU, both as a share of value and number of total transactions (See Annex 8, Figure II)**. It experienced a spike for both types of instruments only during March/ April 2020 from which both have recovered (albeit more slowly in the case of equity instruments)**.** This indicates that in normal market circumstances settlement in the EU can be relatively efficient. Quantitative evidence suggests that, in relative terms, the buy-in regime targets a small proportion of the total volume of transactions but will have an impact on the pricing and liquidity of a much larger percentage of overall transactions.[130]

Nevertheless, even if settlement efficiency in the EU seems to be stable or improving slightly, fail rates in the EU still remain higher than in, e.g. the US where about 2% of all US treasuries and mortgage backed securities transactions fail.[131] Different levels of settlement efficiency between national capital markets can partly explain the lower overall EU settlement efficiency[132].

2.2.3. *Insufficient insight into the activities of third-country CSDs*

Under CSDR, third-country CSDs providing services in the EU provide **insufficient insight into their activities** in relation to financial instruments constituted under the law of a Member State, in particular when they provide services under the grandfathering clause (see section 2.3.5). This leads to potential risks for the whole settlement ecosystem, and in particular on EU authorities, EU CSDs and issuers.

First, **EU authorities are not aware of the activities of third-country CSDs** in the EEA, a fact underlined both by ESMA and several respondents to the targeted consultation[133]. Some third-country CSDs operating in the EU are not subject to any notification requirement (see section 2.3.5). EU authorities therefore have no information on which services they provide, their volume or the Member States affected by them. This means that, if needed, neither issuers nor public authorities at national and EU level can assess the impact of these CSDs on the **financial stability of the EU**.

Second, certain third-country CSDs follow different rules than those EU CSDs are subject to, and provide services in relation to the same financial instruments (see section 2.3.5). The lack of information on third-country CSDs' activities may create a risk for investors in those cases where the legislation governing them does not offer the same level of protection than EU legislation would.

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129 Data generated through the Securities Trading, Clearing and Settlement Statistics Database, European Central Bank, https://sdw.ecb.europa.eu/browse.do?node=9691131.
130 Ibid.
131 K. Burne, 'How to succeed in fixing settlement fails', Aerial View, Bank of New York Mellon, 2020.
132 Based on confidential information provided to DG FISMA services.
133 ESMA letter to the European Commission, 'ESMA's Proposals regarding the Review of the CSD Regulation (CSDR), 20 May 2021, https://www.esma.europa.eu/sites/default/files/library/esma70-156-4519_letter_to_ec_-_csdr_review.pdf .

Third, **the lack of information on third-country CSDs' activities may create a risk for investors**. The Commission has not assessed the rules to which CSDs operating under the grandfathering clause are subject, despite the fact that they provide services in relation to the same financial instruments EU CSDs do (see section 2.3.5). The lack of information on those CSDs' activities may create a risk for investors where the legislation governing them does not offer the same level of protection as EU legislation.

2.3. What are the problem drivers?

2.3.1. Burdensome and unclear passporting requirements for CSDs

A **core objective of CSDR was to dismantle the barriers** to cross-border settlement in order for authorised CSDs to enjoy the freedom to provide services within the EU.

To ensure an appropriate level of safety in the provision of services by CSDs in another Member State, CSDs are currently subject to a specific procedure in Article 23 of CSDR. Under this article, when CSDs wish to provide notary and central maintenance services in relation to financial instruments "*constituted under the law of another EU Member State*" or to set up a branch in another Member State a specific procedure needs to be followed, involving the approval by the host national authority. In particular, they should communicate to the competent authority of their home Member State information including, where relevant, **an assessment of the measures the CSD intends to take to allow its users to comply with the national law referred to in Article 49(1)**.

These requirement of the CSDR passporting process aimed to ensure that the relevant pieces of national legislation would be taken into account and would still be complied with. However, such requirements allow the host competent authority to verify this only once, when assessing the passporting request, and not on a continuous basis. Furthermore, the possibility to refuse the passport does not seem to have been used by host competent authorities[134].

26 CSDs have been authorised under CSDR, out of which 15 provide cross-border services in the EEA.[135]

Further to these first passporting procedures, the majority of stakeholders[136] and Members States[137] now generally agree that **the passporting procedure is burdensome** (one CSD even noted that it stopped providing services with respect to foreign securities in order to avoid it[138]) **and some of its requirements are unclear** and could result in **divergent interpretations** by national authorities, thus **reducing CSDs' cross-border activity and leading to disproportionate compliance costs (see sections 2.2.1 and 2.2.2).** As underlined by one stakeholder: "*the rules in CSDR Article 23 – together with divergent application by National Competent Authorities (NCAs) of Article 23 and the closely related Article 49.1 list – have reduced the possibility for CSDs to offer services as Issuer CSDs for instruments issued under the law of another Member State*."[139]

[134] ESMA Report on cross-border services (see note 50).
[135] https://ecsda.eu/.
[136] Summary Report of the Commission CSDR targeted consultation (see note 92).
[137] Member States, based on the Member States' Experts Group meeting held in July 2021 and September 2020 as well as the targeted consultation, also agree that the CSDR passporting requirements are unclear and burdensome.
[138] Summary Report of the Commission CSDR targeted consultation (see note 92).
[139] Euronext, response to the Commission CSDR targeted consultation (see note 106), page 16.

The **costs per passport** are estimated to amount on average to ca. **EUR 30 000**.[140] This means that, at least theoretically, for a CSD to be able to provide services for financial instruments constituted under the law of 26 other Member States it may be required to pay on average about **EUR 780 000**.[141] Similarly, internal resources in terms of the time required to prepare an application for a passport are estimated at 1-3 months (1 FTE). [142] At least theoretically, for a CSD to be able to provide its services throughout 26 other Member States **it needs to dedicate one FTE that would have to spend between 26 and 78 months (i.e. 6.5 years)**.[143] Once a passport is granted, the applicant CSD also has to continue to monitor it to ensure ongoing compliance, which also entails costs. These costs are estimated at on average ca. EUR 2 000 per passport per year.[144] This means that, at least theoretically, when the CSD has obtained a passport in 26 other Member States it may be required to pay on average about **EUR 52 000 per year.**

Given, amongst others, the high cost of the passport, CSDs require a minimum amount of activity in order to provide services cross-border. This means that cross-border services are generally provided to larger issuances in order to make them more economically viable, potentially limiting the access of smaller- and medium-sized companies to the benefits of the single market.[145]

The costs of passporting are less significant for authorities; ranging from ca. EUR 1 000 per passport for the home national authority[146] to EUR 3 000 for the host national authority. This means that, at least theoretically, a CSD that would decide to passport in 26 Member States would generate estimated costs of ca. EUR 79 000.[147]

Annex 6 provides further examples of burdensome and unclear passporting requirements.

Finally, the effects of the burdensome and unclear passporting requirements are illustrated by the figures showing the slow progression of provision of cross-border services (see section 1.3). According to ESMA "*there has been a limited progression of the provision of CSD services on a cross-border basis within the EU since of the entry into force since 2017 and in the context of the progressive entry into force of CSDR*".[148]

2.3.2. Insufficient coordination and cooperation between authorities

CSDR requires the cooperation of authorities that have an interest in the operations of CSDs that operate domestically and cross-border. **Nonetheless, the supervisory arrangements remain fragmented and can lead to differences in the allocation and nature of supervisory powers depending on the EU CSD concerned**. This in turn creates barriers to the cross-border provision of CSD services, perpetuates the remaining inefficiencies in the EU settlement market and has negative impacts on the stability of EU financial markets.

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[140] Commission calculations based on confidential information provided to DG FISMA services.
[141] Commission calculations based on confidential information provided to DG FISMA services.
[142] Commission calculations based on confidential information provided to DG FISMA services.
[143] Commission calculations based on confidential information provided to DG FISMA services.
[144] Commission calculations based on confidential information provided to DG FISMA services.
[145] Supported by confidential provided to DG FISMA services.
[146] Commission estimates based on confidential data provided by one authority to DG FISMA services. This estimate covers only the costs of interactions between the host and home NCAs. The costs of analysing of the passporting request by the home NCA is much higher in itself and varies depending on the complexity of the file.
[147] Commission calculations based on confidential information provided to DG FISMA services.
[148] ESMA Report on cross-border services (see note 50), para. 127.

Notwithstanding ESMA's competence to promote supervisory convergence, the powers of national supervisors and the requirements for CSDs are interpreted differently across the EU resulting in a significant heterogeneity in supervisory practices, in particular as regards CSDs that operate cross-border.

First, **insufficient cooperation between home and host supervisors prevents the creation of a single market for CSD services,** as acknowledged amongst others by ESMA and the CMU High Level Forum. CSDR does not ensure the effective cooperation between home and host national supervisors for several reasons:

- **formal cooperation of home and host authorities on a continuous basis** (through the establishment of the so-called 'cooperation arrangements') is required only for CSDs that **establish a branch in a host Member State** or **when the activities of a CSD are of substantial importance for the functioning of the securities markets and the protection of the investors** in that host Member State. This means that only for **certain CSDs with activities in host Member States** structural and ongoing cooperation between home and host authorities is required. For other situations, home and host authorities may cooperate on an ad hoc basis on request. CSDs of substantial importance to different host Member States are subject to national supervisors' divergent interpretations as to the content of CSDs' reporting obligations, which can be burdensome especially for small CSDs.[149] Furthermore, due to the absence of structured cooperation between the home and host authorities before the granting of the passport, CSDs face widely divergent interpretations of the same requirements, as illustrated by the differences in the time and cost that each passport requires (see Section 2.3.1).
- It is not specified **what these cooperation arrangements should entail in practice.** This means that it is up to each home supervisor to decide when setting them up.
- CSDR states that when a CSD is of substantial importance for the functioning of the securities markets and the protection of the investors in more than one host Member State, **it is up to the home Member State to decide that such cooperation arrangements are to take the form of a college**. To date **only one college has been set up** (with six authorities from four Member States, without ESMA's participation). The experience of that home supervisor has been positive, as it serves as good forum for discussion, information exchange and enables an exchange of expertise, potentially even dividing tasks.

Second, CSDR **does not sufficiently consider the fact that several CSDs are part of larger groups comprising several CSDs or financial market infrastructures**. CSDs in a group may outsource key IT infrastructure components, activities and processes (e.g. risk management, cyber security) to other group entities and major strategic, business, risk management decisions and governance may be established (directly or indirectly) at group level. While during the authorisation process CSDR provides for the consultation of competent authorities from other Member States where the CSD is part of a group of CSDs, the current supervisory and cooperation approach focuses on individual CSDs, and not on the group or the entity which has been outsourced to. Nonetheless, decisions made by the authority of one CSD in the group can impact the other financial market infrastructures in the group.[150]

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149 Based on confidential information provided to DG FISMA services.

150 Information received from the ESCB.

As an example to illustrate the above, Figure III in Annex 8[151] includes the **governance structure of one of the biggest groups of CSDs in the EU, Euroclear**. Euroclear SA is the parent company for six domestic CSDs and an ICSD, Euroclear Bank. **Three of those domestic CSDs** (Euroclear France, Belgium and the Netherlands) use a **common settlement platform (ESES)** and, amongst others, use a **common admission process**. While the Belgian national supervisor cooperates with the French and Dutch overseers and market supervisors,[152] this cooperation does not take place under the CSDR framework and ESMA is not involved.

Finally, **regarding domestic CSDs**, there is insufficient cooperation and supervisory convergence amongst authorities interested in CSDs' activities. This means that their concerns may not be sufficiently taken into account by the national authority when making decisions. One stakeholder noted that it was not easy to get a good understanding of the overall functioning of the CSD, the supervisory approach, the interpretation and application of the regulatory provisions, the aspects of concern for the competent authority, the views/opinions of the other authorities if others were involved, etc. Furthermore, some authorisation and review and evaluation processes revealed a different understanding and application of various requirements as well as different readings of background documents, which may impact the consistent application of CSDR and distort the level playing field.

Additionally, while CSDR requires national supervisors to involve other relevant authorities, i.e. central banks, in the authorisation of CSDs, the former are not required to inform the latter if and how their views have been considered in the outcome of the authorisation process and if additional issues have been identified. **This means that relevant central banks may not be able to express their views on newly identified issues** or they may not know that their concerns have not been taken on board, in which they could adopt a more rigorous oversight approach, especially in areas of concern.

2.3.3. Restrictive requirements for provision of banking services related to settlement in foreign currencies

An important element of the functioning of CSDR is the banking services that CSDs can offer to clients[153] in addition to the core CSD services and other non-banking settlement services.[154] As noted, the provision of banking services is a prerequisite to settle in foreign currencies, if no access to the relevant central bank is practical or available.[155] **Nonetheless, the requirements for the provision of banking-type services related to settlement are restrictive, leading to both a reduction of CSDs' cross-border activity and to disproportionate compliance costs (see sections 2.2.1 and 2.2.2).**

First, under CSDR, apart from being authorised themselves to provide banking services, CSDs may also use a **designated credit institution** for such services. Nonetheless, the conditions set out in CSDR for such institutions are very strict[156] to mitigate risks to financial stability: in addition to having to be authorised as a credit institution under the

[151] https://www.euroclear.com/about/en/business/Becomingaclient/BecomingaclientESES.html.

[152] National Bank of Belgium 'Financial Market Infrastructures and Payment Services Report 2021', p. 33.

[153] Section C of the Annex of CSDR lists the banking type ancillary services that must be directly related to the core settlement services of a CSD of which the 2 most important are providing cash accounts and intraday credit.

[154] Section B of the Annex of CSDR.

[155] In addition, one of the objectives of CSDR is to promote Delivery versus Payment, to reduce risks for participants in securities transactions.

[156] Article 54(4) of CSDR.

applicable EU banking legislation (Capital Requirements Regulation, Capital Requirements Directive[157]) and to comply with additional prudential and liquidity requirements under CSDR,[158] **designated credit institutions can only offer services in relation to settlement**. This means that there is a **very limited business case** for such entities, as also evidenced by the fact that **no such institutions exist to date**. Furthermore, CSDR requires that designated credit institutions do not carry out themselves any of the core CSDR services (i.e. notary, central maintenance, settlement). This means that **CSDs that have been authorised to provide banking-type services themselves cannot function as designated credit institutions to other CSDs** (even if they are part of the same corporate group), which greatly limits synergies and restricts access to commercial bank money.

Second, the **threshold under which a commercial bank may provide banking service**s (i.e. the total value of cash settlement is less than 1% of the total value of all securities transactions against cash settled in the books of the CSD and does not exceed a maximum of EUR 2.5 billion per year)[159] is considered by the majority of stakeholders, including CSDs and their association as well as a public authority, as too **low for the majority of EU CSDs to be able to compete in the settlement in foreign currencies.** CSDs without a banking license could increase their settlement activity in foreign currencies over a 5 year horizon to ca. 5% of their total yearly settlement activity.[160] As an example, for smaller CSDs with lower turnover ratio,[161] e.g. 11, the current threshold of EUR 2.5 billion settlement per year would be reached with issuance corresponding to EUR 229 million[162] – less than half the size of a regular bond issue, leaving no possibility to offer issuance to others in the same or other currencies in commercial bank money or even allow the same entity to do other issuances.

2.3.4. Unclear and complicated requirements for settlement discipline

CSDR introduced rules on settlement discipline to prevent and address failures in the settlement of securities transactions and therefore ensure the safety of settlement (see section 2.2.2). Despite the absence of experience in applying the rules, the development and specification of the framework in the relevant RTS has allowed all interested parties to better understand the regime and the challenges its application could give rise to, especially at times of crisis, e.g. the COVID-19 crisis in spring 2020.

A large majority of respondents to the Commission targeted consultation (public authorities, CSDs, CCPs, banks, asset management companies, market makers, and their respective associations), considered that the settlement discipline framework should be

[157] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013.

[158] Articles 54(4)(e) and 54(8) of CSDR and Commission Delegated Regulation (EU) 2017/390.

[159] Article 54(5) of CSDR.

[160] Based on confidential information provided to DG FISMA services.

[161] The asset turnover ratio measures the value of a company's sales or revenues relative to the value of its assets. The asset turnover ratio can be used as an indicator of the efficiency with which a company is using its assets to generate revenue. The higher the asset turnover ratio, the more efficient a company is at generating revenue from its assets.

[162] Euronext response to the Commission CSDR targeted consultation (see note 106).

reviewed.[163] Member States took a similar position in the Member States' Experts Group meeting in July 2021. They almost unanimously expressed concerns about the current design of mandatory buy-ins and their influence, in particularly on trading activity, liquidity or the competitiveness of EU capital markets. ESMA also supported a delay in the application of the buy-in regime noting that *"ESMA is aware of market participants' serious difficulties regarding the implementation of the buy-in regime.*"

Two main issues have been identified: the lack of clarity and the complexity/burden of the settlement discipline requirements. These drivers lead to **disproportionate compliance costs**, in so far as the costs of complying with the framework potentially seem to outweigh the achievable benefits (see section 5.1.4).

First, **the requirements of the settlement discipline regime are often unclear,** creating legal uncertainty, thus increasing compliance costs. This lack of clarity is also shown by the number of Q&As received by ESMA and the Commission. Since 2017, ESMA has frequently updated its CSDR Q&As, with currently[164] seven Q&A's related to settlement discipline. More than 25 Q&As on settlement discipline are also currently being assessed. The need to clarify questions related to the settlement discipline regime puts an additional burden on market participants, but also the relevant authorities. This uncertainty means that companies have to obtain additional legal opinions on how the rules should be applied, to enable them to adapt existing trading and reporting procedures. Should those rules subsequently be interpreted differently, additional costs will be incurred to re-adapt.

The unclear requirements are primarily linked to the scope of cash penalties and buy-in rules. One business association stated "*…the different provisions of CSDR setting out the scope of the requirements such as settlement fails reporting, cash penalties or buy-ins are not always clear. This lack of legal certainty could potentially lead to reducing the efficiency in securities settlement*."[165]

- **Unclear scope of rules on cash penalties:[166]** A cash penalty applies for each day that a transaction fails to be settled after its intended settlement date. Examples of lack of clarity relate to the types of securities transactions covered and the scope of entities concerned by cash penalties.[167] As an example, the scope of "transactions" is not defined in CSDR; however certain transactions are outside CSD participants' control. It is therefore unclear whether such transactions should be within the scope of the cash penalty regime. This uncertainty generates costs when CSDs implement the IT systems to monitor cash penalties, requires additional legal advice and increases potential legal risks. The questions about the interpretation of CSDR stem not only from the text of the Regulation itself but also from the delegated acts; e.g. Commission Delegated Regulation (EU) 2017/389 states that, in certain circumstances, the calculation of penalties rates should use the official interest rate for overnight credit charged by the central bank issuing the settlement currency. However, in at least two Member States, it has been reported recently that central banks do not have this official rate and therefore the calculation of the penalties cannot fulfil this requirement.

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163 Summary Report of the Commission CSDR targeted consultation (see note 92).
164 CSDR Q&As, ESMA70-156-4448, 31 March 2021, https://www.esma.europa.eu/sites/default/files/library/esma70-708036281-2_csdr_qas_2.pdf.
165 ESCDA, response to the Commission targeted consultation on the CSDR review.
166 A cash penalty applies for each day that a transaction fails to be settled after its intended settlement date.
167 Summary Report of the Commission CSDR targeted consultation (see note 92).

- **Unclear scope of rules on buy-ins**: there is lack of clarity on a wide range of issues, i.e. types of securities covered, scope of entities concerned, and in-scope transactions.[168] For example, while CSDR refers only to participants (i.e. failing participant and receiving participant), multiple terms are used in Level 2 (e.g. failing trading party, failing trading venue member, failing clearing member) which could create difficulties of interpretation and lead to legal challenges.[169]

Second, the requirements of the settlement discipline regime are often complicated and increase compliance costs. In addition to one-off costs incurred to adapt IT systems,[170] the two examples below on contractual repapering (i.e. update of existing contracts) and the use of buy-in agents show how the actual application of the requirements could increase costs for market participants.

Trading parties that settle transactions in-scope of mandatory buy-ins **would need a global repapering exercise.**[171] This would ensure that appropriate contractual arrangements are in place between the relevant counterparties to guarantee effective application and enforceability of the buy-in requirements, even where some parties are located outside the EU.[172] EU securities valued EUR 33.5 trillion and bonds valued at EUR 13.2 trillion could be subject to this exercise[173] showing the **one-off compliance costs it could generate**. Data suggests that, on average, each firm would need to repaper 27 120 agreements, taking on average 10 months to complete.[174] The scope of the repapering is however related to and reliant on the interpretation of the scope of the rules.

Increased compliance costs result also from the requirement to **use buy-in agents.**[175] The concerns relate mainly to the **limited number of third-party buy-in agents** (currently only one stakeholder has made substantial investments to comply with these rules and establish themselves as buy-in agent). This adds one-off investment and ongoing costs to trading for asset managers in terms of onboarding, connectivity, fees and collateral requirements as well as impacting best execution and adding concentration risk[176]. In

[168] To the question 34 of the Commission targeted consultation on whether the scope of the buy-in regime and the exemptions applicable should be clarified, 62 responded that they agree, while 2 being neutral and one disagreeing.

[169] AFME response to the Commission CSDR targeted consultation (see note 127) "*the term participant including references to 'failing participant' and 'receiving participant' is used inconsistently throughout the Level 1 and Level 2 texts (...). Without a clear distinction of what provisions relate to which actor in the 'trade through to settlement chain' the SDR may be, in its application, fraught with disputes and legal challenges*".

[170] "CSDR: Settlement discipline regime toolkit", Deutsche Bank, September 2019.

[171] Article 25 of the RTS on settlement discipline. According to a joint trade association letter *" [...] the implementation of the CSDR mandatory buy-in regime is a significant undertaking for the entire financial market, not only in Europe, but globally. This involves not only extensive system developments, but also major client outreach across multiple markets and jurisdictions to undertake contractual papering and remediation in line with the requirements set out in Article 25 of the Commission Delegated Regulation (EU) 2018/1229 ('RTS')*" Joint-Trade-Association-Letter-regarding-Implementation-of-the-CSDR-Settlement-Discipline-Regime_Final.pdf (ebf.eu)

[172] Association of Global Custodians response to the Commission CSDR targeted consultation, Q. 32.1

[173] Based on confidential information provided to DG FISMA services.

[174] Based on confidential information provided to DG FISMA services.

[175] If the settlement of a transaction fails, the receiving party of the transaction is obligated to appoint a buy-in agent to execute a buy-in

[176] BlackRock response to the Commission CSDR targeted consultation, Q. 34.1, https://www.blackrock.com/corporate/literature/publication/ec-consultation-on-the-review-of-regulation-on-improving-securities-settlement-in-the-european-union-and-on-central-securities-depositories-020221.pdf.

addition, some stakeholders claim that the current buy-in offering may not be compatible with the diverse needs of market participants.[177] Therefore, certain market participants (e.g., asset managers) may have to provide the buy-in agent with sufficient liquidity even if they will use the service rarely.[178] Due to the costs and risks linked to the role of buy-in agents, some market-makers traditionally acting as buy-in agents for specific instruments have stopped providing that service. Other concerns related to **high costs,**[179] the potential risk associated with **abuse of a dominant position by the agents** or the **difficulty to execute a buy-in for instruments with limited supply** (the use of substitute instruments has been advocated in such a case). These further drive up firms' compliance costs.

2.3.5. Insufficient reporting for third-country CSDs

Under CSDR, certain **third-country CSDs providing services for financial instruments constituted under the law of a Member State could benefit from a lighter regulatory regime**. The insufficient reporting by third-country CSDs leads to insufficient insight into their activities (see section 2.2.3), mainly due to two factors.

First, third-country CSDs[180] that provide services in relation to financial instruments constituted under the law of a Member State under the national laws applicable before the adoption of CSDR can continue to do so until they have been recognised by ESMA (the "grandfathering clause").[181] The objective of that clause was to defer application of CSDR to provide CSDs with sufficient time to apply for recognition. However, even though CSDR was adopted in July 2014,[182] **the grandfathering clause still applies and does not have an end-date.**[183] This means that third-country CSDs have no incentive to apply for recognition to ESMA. To date, no third-country CSD, other than the UK CSD, has applied for recognition.

Under the current regime, **third-country CSDs** benefiting from the grandfathering clause **can indefinitely provide services** in relation to financial instruments constituted under the law of a Member State even though**:** (a) they do not have to comply with CSDR or rules that have been considered as equivalent by the Commission and, (b) they have not been recognised by ESMA - while authorised EU CSDs with which they compete have to comply with CSDR. Third-country CSDs benefiting from the grandfathering clause are also not under any notification requirements regarding their activities in the EU. Hence, they are not required to **provide any information to EU authorities.**

Second, settlement services are outside the scope of the CSDR third-country regime. Under CSDR,[184] third-country CSDs that do not benefit from the grandfathering clause,

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[177] Confidential information provided to DG FISMA services. Some asset management firms claim that because no transactions are concluded on asset managers' own accounts, (they are all executed as an agent for fund and client accounts), all fund and client accounts globally have to be on-boarded with the buy-in agent even though only a fraction of these accounts may ever require a buy-in. This requires prefunding ahead of the execution of a buy-in.

[178] Confidential information provided to DG FISMA services.

[179] Confidential information provided to DG FISMA services.

[180] It is worth noting that both third-country CSDs and EU CSDs can benefit from the grandfathering clause. As of May 2021, to our knowledge, CSDs of one Member State and one EEA country are still operating under the grandfathering clause.

[181] Article 69(4) of CSDR.

[182] However, please note that the deadline to apply CSDR in EEA countries was 30 June 2020.

[183] As an exception, in Liechtenstein the grandfathering clause for third-country CSDs providing services therein (i.e. Six, the Swiss CSD) ends 5 years after the date of entry into force of Council Decision (EU) 2019/134.

[184] Article 25 of CSDR.

may provide services in relation to financial instruments issued under the law of a Member State, including through setting up a branch, only if they comply with the CSDR third-country framework. Requirements applying to third-country CSDs **differ however depending on the type of service (**notary, central maintenance, settlement) they intend to provide. A recognition by ESMA is required for notary or central maintenance services; a condition of this recognition is that the Commission has adopted an equivalence decision, determining that the legal and supervisory arrangements of the third country ensure that CSDs authorised therein comply with legally binding requirements which are in effect equivalent to the requirements of CSDR. Settlement services provided by third-country CSDs do not require recognition by ESMA.

Despite the fact that settlement is one of the three core services provided by CSDs, third-country CSDs may provide settlement services for securities issued under the law of a Member State without applying for recognition by ESMA. In that case, third-country CSDs do not have to comply with CSDR or at least equivalent rules nor are they required to provide any information or notification regarding their activity. **They are also not subject to any type of supervisory activity by an EU supervisor.**

To conclude, third-country CSDs operating in the EU under the grandfathering clause or providing settlement services might not comply with CSDR or equivalent rules. National and **EU authorities have very little information on the activities of these third-country CSDs**, as confirmed also by ESMA.[185]

2.4. How will the problem evolve?

2.4.1. Ongoing inefficiencies in the EU settlement market

The ongoing inefficiencies in the EU settlement market stem from two main problems: barriers to cross border settlement (see section 2.2.1) and disproportionate compliance costs (see section 2.2.2).

Under a baseline scenario, CSDR is unchanged, barriers to cross-border settlement through: burdensome passporting requirements; insufficient coordination among authorities; burdensome, even restrictive, requirements for the provision of banking services; and a disproportionate settlement discipline regime would remain.

Competition among CSDs within the EU would not improve. For example, challenges accessing banking services and in particular settling in foreign currencies would reduce the possibility of CSDs offering multi-currency services therefore reducing their attractiveness. Consequently, cross-border investment will remain at a lower level than could otherwise be achieved, leading to a sub-optimal pan-EU settlement market.

The entry into application of mandatory buy-ins could further increase the costs for CSDs, investors and market makers (see section 2.3.4). This could lead to a reduced willingness by liquidity providers to create markets and offer prices for a security when they do not have access to inventory or for securities which cannot be readily sourced. Market makers will find price-setting complicated for these instruments as it is unclear whether the trade will be subject to a mandatory buy-in. This could also lead to increased higher bid-offer spreads for investors as market makers hedge risks related to such difficulty to set prices of less liquid instruments. This, in particular, could affect negatively less liquid instruments and even lead to a substantial drop of liquidity, as market makers withdraw from making markets for these instruments.

[185] ESMA letter to the Commission (see note 133).

The EU post-trade landscape will remain fragmented along national lines, impairing cross-border investment due to additional costs caused by added complexity relative to other jurisdictions, e.g. the US and the UK. Transaction costs in the EU could increase with full entry into force of the settlement discipline regime (see section 2.2.1).

If nothing is done, it will continue to be easier to do business outside the EU than within the EU. Participants will increasingly be attracted to issuing their securities and settling in non-EU 27 countries as EU CSDs' ability to offer a wide range of services including in different currencies is limited by burdensome passporting processes and restrictive requirements for the settlement in commercial bank money. In addition, lending market participants may increase the amount of stock they hold back as buffer by up to 10% to reduce the risk of buy-ins.[186] This would represent a fall of EUR 398 billion in securities available to facilitate market liquidity and banking financing activities.[187]

Together these impacts negatively impact the safety and efficiency of EU financial markets, limiting the potential benefits of a larger-scale integrated EU market. They would be to the detriment of the EU financial system as a crucial building block of CMU would perform sub-optimally, to the detriment of EU investors and businesses.

2.4.2. Negative impacts on stability of EU financial markets

The negative impacts of CSDR on the stability of EU financial markets stem from three main problems: barriers to cross border settlement (see section 2.2.1), insufficient insight on third-country CSDs activities (see section 2.2.3) and disproportionate compliance costs (see section 2.2.2).

First, cross-border settlement remains difficult, limiting competition in the EU, hampering the development of CMU. Inability to ensure swift cross-border settlement may restrict activity to national capital markets, which would **make them more vulnerable to country-specific asymmetric shocks** that may over time endanger the stability of the EU capital market. If nothing is done, CSDs will continue to find providing cross-border services difficult. The level of cross-border activity will remain reduced, limiting competition and entrenching fragmentation of EU capital markets along national borders, potentially exposing EU capital markets to asymmetric shocks, in particular for some shallow national markets that cannot rely on abundant liquidity.

Second, the insufficient insight into third-country CSDs' activities could potentially lead to financial stability risks. EU and national authorities alike currently do not have information on most third-country CSDs activities in the EU; this means that they cannot evaluate whether any of these CSDs are important for the EU financial stability, which in itself creates a potential risk to financial stability. If nothing is done, this risk will persist. Furthermore, market participants may choose to use the services of third-country CSDs outside the transparency arrangements set by CSDR, potentially allowing for a build-up of risk that may threaten the stability of the EU capital market.

Third, if no specialised credit institution can provide access to commercial bank money to CSDs under the CSDR due to disproportionate compliance costs, the risk is that non-bank CSDs may not be able to provide DvP settlement in foreign currencies to their participants. This could lead to **transactions being processed free of payment instead of versus payment, leading to less safe markets** and undermining the CSDR's objective of promoting DvP settlement. The decrease in foreign currency settlement at

[186] Based on confidential data provided to DG FISMA services.
[187] Based on confidential data provided to DG FISMA services.

non-bank CSDs would constitute a step backwards if it results in the settlement of these transactions outside CSDs.[188]

3. WHY SHOULD THE EU ACT?

3.1. Legal basis

CSDR has a comprehensive regulatory framework for the settlement of financial instruments in the EU as well as common rules on the organisation and conduct of CSDs to promote safe, efficient and smooth settlement. The legal basis for CSDR was Article 114 of the Treaty on the Functioning of the European Union (TFEU) as it aimed to create an integrated market for securities settlement with no distinction between national and cross-border securities transactions. Considering that this initiative proposes policy actions to allow the achievement of these objectives more effectively and efficiently, amendments to CSDR would be adopted under the same legal basis.

3.2. Subsidiarity: Necessity of EU action

The review could amend certain provisions of CSDR, in particular to clarify and simplify burdensome and unclear requirements, reduce administrative burden and costs, and ensure that authorities have enough information to monitor risks. EU action should therefore ensure that CSDR's regulatory requirements are more effective, efficient and proportionate, are applied uniformly, and guarantee a sound and consistent regulatory framework for securities settlement in the EU and the operations of CSDs, both of which are essential foundation stones for the development of CMU as well as to ensure a safe and efficient single market for financial services.

3.3. Subsidiarity: Added value of EU action

The 2020 CMU Action Plan[189] explicitly acknowledged that amending CSDR could help develop a more integrated post-trading landscape in the EU and thus contribute to the development of CMU. The objectives of CSDR, namely to lay down uniform requirements for the settlement of financial instruments in the EU and rules on the organisation and conduct of CSDs, to promote safe, efficient and smooth settlement cannot be sufficiently achieved by the Member States alone, as the co-legislators already acknowledged in 2014 when adopting CSDR. Similarly, today Member States and national supervisors cannot solve on their own the challenges arising from the burdensome and unclear CSDR requirements or the risks resulting from diverging national supervisory practices, in particular where those stem from primary or secondary legislation. In addition, Member States and national authorities cannot address on their own the risk to the EU financial stability that the lack of information on the activities of third-country CSDs may pose, as the conditions for the regime are contained in CSDR.

As such, the objectives of CSDR cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale of actions, be better achieved at EU level in accordance with the principle of subsidiarity as set out in Article 5 of the TEU.

[188] European Post-Trade Forum Report, (see note 11), p. 117.

[189] Commission Communication 'A Capital Markets Union for people and businesses – New Action Plan' (see note 10).

4. OBJECTIVES: WHAT IS TO BE ACHIEVED?

4.1. General objectives

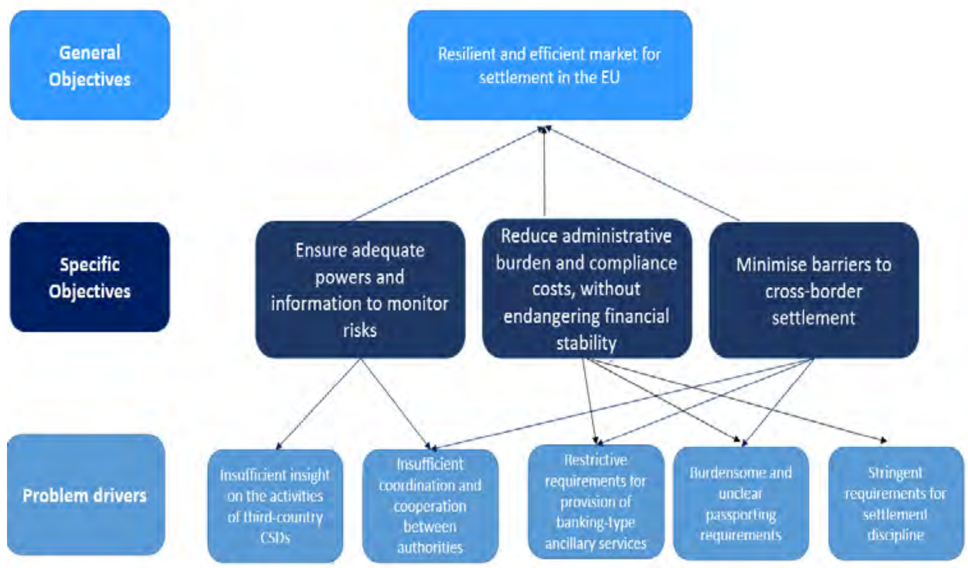
The general objective of CSDR remains to create a safe and efficient market for the settlement of securities transactions in the EU. This could be achieved by enhancing cross-border competition between CSDs, improved risk monitoring for EU and non-EU CSDs, more efficient supervisory cooperation and reduced compliance costs, where appropriate, for post-trade service providers, market participants and competent authorities. The benefits should however not come at the expense of the resilience and stability of the EU financial system. In this respect, the present initiative aims to render the application of CSDR more proportionate, effective and efficient and, by fine-tuning certain requirements, to reduce the regulatory and compliance burden for market participants where compliance costs outweigh benefits, but without endangering financial stability. The initiative thus contributes to the Commission's Better Regulation Agenda and the Regulatory Fitness and Performance (REFIT) programme.

The overarching policy objective will be achieved via the pursuit of the following specific objectives:

- Minimise barriers to cross border settlement;
- Ensure adequate powers and information to monitor risks;
- Reduce administrative burden and compliance costs, without endangering financial stability;

This initiative is also in line with the objectives of the CMU. Efficient and resilient post-trading systems are essential elements for the well-functioning of the CMU. Better means of cooperation between competent authorities, streamlined procedures, better access to liquidity for CSDs and credit institutions will contribute to integrating the EU capital market, that is currently fragmented along national lines, will strengthen cross-border investment and will lower investment costs for market participants while ensuring that the associated risks are contained and managed. Effective and efficient CSDR rules thus contribute to achieving the objectives of the CMU and help making post-trade markets an important building block of an economy that works for people, in line with the strategic priorities of the Commission.

Figure VII: Objective tree



4.2. Specific objectives

There are three specific objectives, relating to the five problem drivers (see section 2.3).

4.2.1. Reduce administrative burden and compliance costs, without endangering financial stability

The effectiveness and efficiency of applying CSDR should be improved by simplifying and clarifying the passporting process. This should, in turn, enable more competition for CSD services across borders. Furthermore, to facilitate settlement in foreign currencies, and promote more cross-border activity, the requirements faced by CSDs and credit institutions when providing banking-type ancillary services should be more proportionate. Lastly, the efficiency and safety of settlement should be ensured through more proportionate requirements for settlement discipline, which balance the reliability of settlement with potential negative impacts on trading behaviour and markets, including financial stability.

Problem	Problem drivers	Specific objective
Disproportionate compliance costs	Burdensome and unclear passporting requirements for CSDS	Reduce administrative burden and compliance costs, without endangering financial stability
	Restrictive requirements for provision of banking services related to settlement	
	Complicated and unclear requirements for settlement discipline	

4.2.2. Minimise barriers to cross-border settlement

Provision of cross-border services should be enhanced by: (a) clarifying and streamlining the passporting process for CSDs offering such services or setting up a branch in another Member State; (b) increasing the cooperation between authorities involved in the supervision of the relevant CSDs; and (c) improving access to banking services related to settlement.

Problem	Problem drivers	Specific objective
Barriers to cross-border settlement	Burdensome and unclear passporting requirements for CSDs	Minimise barriers to cross-border settlement
	Insufficient coordination and cooperation between authorities	
	Restrictive requirements for provision of banking services related to settlement	

4.2.3. Ensure adequate powers and information to monitor risks

The insufficient insight of EU authorities into the activities of third-country CSDs should be addressed by increasing the reporting obligations for such CSDs. This should ensure that adequate information is available to monitor risks. Furthermore, while better coordination and cooperation between authorities involved in the supervision of EU CSDs aims primarily at minimising barriers to the cross-border provision of services, it will also provide authorities with increased powers and information to monitor any risks that may be arising from the operation of these CSDs.

Problem	Problem drivers	Specific objective
Insufficient insight into the activities of third-country CSDs	Insufficient reporting by third-country CSDs	Ensure adequate powers and information to monitor risks
	Insufficient coordination and cooperation between authorities	

5. WHAT ARE THE AVAILABLE POLICY OPTIONS?

5.1. What is the baseline from which options are assessed?

This section describes, for each policy option, the most likely scenario is going to be without any further intervention.

5.1.1. Burdensome and unclear passporting requirements

All issues identified in Section 2.3.1 remain. The passporting requirements are unclear and burdensome for CSDs and national authorities, generating costs and lengthy processes. Consequently, cross-border activities of CSDs may stagnate or fall and the administrative burden for CSDs and national authorities remains high. Indirectly, issuers could be negatively impacted as less cross-border CSD activities would mean less competition and reduced choice, preventing them from benefitting from an integrated capital market for financial services. National authorities would continue to face unclear requirements when assessing CSDs' applications to obtain a passport.

5.1.2. Insufficient coordination and cooperation between authorities

All issues identified in Section 2.3.2 remain. Cooperation between authorities in home and host Member States is insufficient, creating obstacles in the cross-border operations of CSDs and hindering the creation of a true single market for CSD services. In particular, communication between authorities in different Member States is not standardised and the same CSD may be subject to different supervisory arrangements and requirements in the different Member States in which it may be operating. Inefficiencies in the cooperation of authorities interested in the activities of CSDs operating domestically also remain.

5.1.3. Restrictive requirements for provision of banking services related to settlement in foreign currencies

All issues identified in section 2.3.3 will remain regarding CSDs' access to commercial bank money. In particular, settlement in foreign currencies by CSDs will continue to be limited as no designated credit institution is likely to be established and commercial banks will remain limited in their service offering (mostly intraday- credit and liquidity to the participants of the CSD). This situation will hamper cross-border securities transactions, e.g. bond issuances in foreign currencies, due to the disproportionate compliance costs of obtaining these services. CSDs will be limited in their choice of providers to settle in foreign currencies, be it designated credit institutions (which do not exist currently) or commercial banks that are only allowed to provide these services within the limits set by CSDR. This runs counter to the EU's objective to ensure a true single market for CSD services.

Although the requirements to provide banking services have a positive effect on the stability of the financial system as liquidity and credit risks attached to these services remain limited, they also affect competition on the EU settlements markets. Due to the restrictiveness in the provision of these services and the compliance costs, new players, whether in the form of a designated credit institutions or commercial banks offering these services, will not enter the market. This runs counter to the core of the CMU Action Plan to enhance the Union's capital markets.

5.1.4. Unclear and complicated requirements for settlement discipline

The settlement discipline regime, as described in Art. 6 and Art.7 of CSDR and Regulation (EU) 2018/1229, would enter into force on 1 February 2022. Retail investors should benefit from improved settlement efficiency due to the fact that market makers often provide prices for many financial instruments without having immediate access to these securities. In case of smaller equity trades which are often carried out by retail investors, the coverage of these sales may be considered as too expensive and cumbersome, leading to no delivery taking place. Settlement discipline measures aim at incentivising market makers to avoid this kind of situation. The settlement discipline regime would also potentially allow investors to consolidate trading positions and rely on cross-border settlement to settle trades, as they would have more confidence that they would be settled. Finally, mandatory buy-ins can be applied by the market. Regulation (EU) No 236/2012 (Short Selling Regulation (SSR)) introduced them for centrally cleared equity transactions. According to some stakeholders, settlement efficiency on intended settlement date is now almost 100% for centrally cleared equity transactions[190]. However, it should be noted that equity trading generally features high levels of liquidity. Implementation and the resulting effect cannot therefore be directly compared to other, less liquid markets.

However, the impact of a miscalibrated settlement discipline regime on overall market conditions could outweigh these benefits for investors. The majority of the potential negative impacts of the settlement discipline regime are likely to be related to mandatory buy-ins. In particular, mandatory buy-ins as currently designed could theoretically widen bid-offer spreads and negatively impact market liquidity, favouring settlement in non-EU CSDs particularly for less liquid securities,[191] remove incentives for securities lending in the securities lending and repo markets and ultimately lead to increased costs for end investors without providing additional benefits to markets or investors.[192] This could affect a broad range of asset classes including corporate bonds, sovereign bonds, securities lending / repo transactions and other exchange traded products.[193] These increased costs would negatively impact investors' returns and their ability to save, and companies' access to capital market funding, especially in times of market stress.[194] Estimates[195] provided suggest that in normal market conditions a mandatory buy-in regime would theoretically increase the mid-offer price by 21 cents or 59% when the regime applies. In times of stress the regime could theoretically increase the mid-offer price by 146 cents or 291% in the event that the current settlement discipline regime applies unchanged. It is thus estimated that up to 4%-5% of trade volume could cease to occur (estimated at up to EUR 7 trillion in 2020, combining debt and equity instruments) in the future. Therefore, applying a mandatory buy-in regime in its current form could potentially impact negatively the efficiency of EU capital markets, leading to wider bid-offer spreads, reduced market efficiency and less incentives to lend securities in the securities lending and repo markets. Such developments may ultimately favour the settlement of less liquid securities in non-EU CSDs.

In particular both equity and debt instruments with a lower floatation, such as less liquid bonds or shares of SMEs, could be negatively affected as investors withdraw from

[190] Clearstream response to the Commission CSDR targeted consultation, https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en.

[191] See BlackRock response to the Commission CSDR targeted consultation, Q. 34.1 (see note 176).

[192] See EFAMA response to the Commission CSDR targeted consultation, Q. 34.1, https://www.efama.org/sites/default/files/publications/21-4005_0.pdf.

[193] Ibid.

[194] See for instance International Capital Markets Association (ICMA), EFAMA, ECSDA, European Association of CCP Clearing Houses (EACH) responses to the CSDR targeted consultation, (all available at https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en).

[195] Based on confidential information provided to DG FISMA services.

making markets/ trading in those instruments. Traders would either have to keep securities on their books to cover any buy-ins, freezing capital, or trade only in instruments where the supply is easily available. This could lead to an even greater concentration of trading on a limited number of instruments, both threatening investors' risk diversification strategies and creating systemic risk. Asset managers may not be able to obtain the securities they want on behalf of investors, and thus may have to make sub-optimal investment decisions or may have to pay a liquidity premium. Furthermore, national authorities, ESMA and the Commission would need to issue numerous Q&As and guidelines to address the lack of clarity in the relevant provisions.

Introducing a mandatory buy-in regime as of 1 February 2022 could also lead to a duplicative re-papering exercise of existing contracts between market players in order to take account of the upcoming rules change potentially introduced under the ongoing review of CSDR; one estimate puts the number of clients' contracts to be repapered at a financial institution at between 30 - 40 000[196] over a period of 10 months. Repapering of client-facing documentation would have to go beyond updates to generic terms and conditions adding complexity to interdependent sets of client documents. A law firm concluded that clauses reflecting clients' mandatory buy-in obligations, including the necessity to appoint a buy-in agent, would be difficult and impracticable to understand in particular for retail investors.[197]

Another related cost will be the obligation to connect to a buy-in agent. Market participants will have to appoint a buy-in agent to carry out the mandatory buy-in in case of delayed settlement. The costs for appointing and connecting to a buy-in agent are high. One estimate provided in the targeted consultation shows that the estimated annual cost of appointing buy-in agents to handle government bond fails in one CSD could amount to between EUR 598 900 294 to EUR 1 197 800 588.[198] One investment fund[199] indicated that connecting all their funds to a buy-in agent would require a one-off cost of EUR 1 million. Operational costs of running a buy-in framework are also potentially high, leading some market participants to consider changing their business model to avoid the requirement to connect to a buy-in agent.[200] This would outweigh the potential postponed cost related to the setting up of a buy-in agent offering by one entity (only one buy-in agent service provider that has emerged so far).[201]

A mandatory buy-in regime could also indirectly negatively affect issuers. Issuance ability and pricing is related to the expected liquidity of the instrument. A decrease in liquidity, from the knock-on effects of the mandatory buy-in regime, could increase borrowing costs for issuers, with the greatest impact likely to fall on smaller and lower credit rated companies, especially in times of stress where access to a wide range of financing channels is needed. Higher issuance costs and limited liquidity could increase

[196] Based on confidential information provided to DG FISMA services.

[197] Simmons & Simmons LLP response to the Commission CSDR targeted consultation Q. 34.1, https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en.

[198] Data provided by ICMA in its response the CSDR targeted consultation, https://www.icmagroup.org/assets/documents/Regulatory/Secondary-markets/CSDR-Settlement-Regulation/ICMACSDR-Review-Targeted-ConsultationFeb-21Detailed-response-020221.pdf. Estimates based on cost of buy-in agents varying between 25 cent and 50 cent handling a volume of fails equal to EUR 239 569 million on Euroclear only.

[199] Based on confidential information provided to DG FISMA services.

[200] BVI response to the Commission CSDR targeted consultation, https://www.bvi.de/fileadmin/user_upload/2021_02_02_BVI_position_CSDR_review.pdf.

[201] This is supported by confidential information provided to DG FISMA services.

the cost of capital for EU issuers, including innovative start-ups and SMEs, who may continue to rely on bank loans or private placements[202] for financing, inhibiting the development of the EU capital market.

Furthermore, there is some evidence that these costs could be born to potentially address a less significant problem, as the majority of fails seem to be resolved between one and five days after the intended settlement date, meaning they would not enter buy-in.[203] It should also be noted that, in general, fails are most likely to appear in less liquid instruments, increasing the probability that even the eventual buy-in may not be successful due to the inability to source the necessary securities.[204] This holds true both for bonds and equity instruments.

Since market participants will not know which transactions will enter a buy-in, stakeholders argue that they will have to disperse the costs of a potential buy-in across a wide spectrum of transactions. At the end of the day, if this were to happen, end-investors would have to pay a higher price for the same security (because of its lower liquidity) and will ask for a higher return. The consequence at the end of the chain would be a higher funding cost for issuers. Hence, some stakeholders argue that in order to incrementally improve a relatively low level of settlement fails, a mandatory buy-in would impact the costs of trading more widely.[205]

While mandatory buy-ins are expected to negatively impact all asset classes, the impact will be most detrimental for less actively traded/illiquid securities, e.g. instruments issued by SMEs, high yield and emerging markets securities. The mandatory buy-in regime in its current form could therefore be perceived to be contrary to the wider CMU objectives, especially when aiming to provide efficient financing to smaller corporate clients and SMEs, whose securities will have lower inherent liquidity and would be disproportionately affected by this regime.

Lastly, there is some limited evidence that the mandatory buy-in regime may also indirectly undermine the CSDR objectives of safe and efficient settlement as companies may migrate to internalised settlement to avoid the burden of the discipline regime. ESMA observed increasing levels of internalised settlement in several jurisdictions accompanied by a high degree of concentration. As such, they called for continuing monitoring, including of this activity and the associated risks.[206]

5.1.5. Insufficient reporting for third-country CSDs

All issues identified in Section 2.3.5 remain. In particular, there would be little information on third-country CSDs' activities. This would directly negatively impact the EU's financial stability as ESMA and national authorities will continue to have no information on these CSDs' activities and therefore will not be able to monitor risks. It would also directly negatively impact EU CSDs which have to comply with CSDR as

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202 A private placement is a sale of shares or bonds to pre-selected investors and institutions rather than on the open market.

203 "ESMA Report on trends, risks and vulnerabilities", European Securities and Markets Authority, ESMA-50-165-1287, No. 2, 2020

204 In instances where the supply of the security is so low it cannot be easily sourced or bought-in if the settlement fail has aged the failed-to entity will receive from the failing seller a cash compensation to restore the economic terms of the transaction. Currently the buy-in may be automatic/mandatory or optional, upon the request of the buyer, depending on the contractual arrangements. Under the CSDR settlement discipline regime the cash compensation would be mandatory.

205 Based on confidential information provided to DG FISMA services.

206 ESMA Report on internalised settlement (see note 86).

well as issuers considering that for third-country CSDs operating under the grandfathering clause, their national supervisory and regulatory framework has not been deemed as equivalent by the Commission.

5.2. Description of the policy options

5.2.1. Burdensome and unclear passporting requirements

The objective is to minimise barriers to cross-border settlement to enhance the cross-border provision of services. Options 3 and 4 may be complementary.

Policy option	Description
Option 1 – Do nothing (baseline)	This is the baseline scenario (see section 5.1).
Option 2 – Reduce the scope of the passporting requirements	The scope of instruments subject to the passporting requirements could be reduced, i.e. they could apply to equities instruments only. Any authorised CSD would be able to provide services for non-equity instruments within the EEA without being subject to the passporting requirements.
Option 3 – Clarify the role and powers of competent authorities and requirements related to national laws	Certain passporting requirements would be clarified, i.e. those related to national laws and regarding the role of the host national authority. For instance, clarifications could include: clarifying which national laws should be considered; deleting the words "where relevant" in Articles 23(3)(e) and 23(6)(a) of CSDR; specifying which provisions need to be considered by non-domestic CSDs for their assessment; specifying the information required; clarifying the role of the home and host authorities, including whether the host authority can oppose the passport.
Option 4 – Replacing the passporting procedure at the host Member State level with a notification	The current possibility for host Member State authorities to reject a passporting request would be removed and replaced by a standardised notification from the home Member State authorities. CSDs wishing to passport their services within the EU would only have to obtain an approval from the home Member State competent authorities. As long as the CSD is authorised in one Member State, the competent authorities of the host Member State would not have to approve or reject the passport.
Option 5 – Combination of Option 3 and Option 4	The current requirements laid down in Article 23 of CSDR would be simplified as per Option 4 and certain aspects of the passporting procedure would be clarified as per Option 3.

5.2.2. Insufficient coordination and cooperation between authorities

The objective is to minimise barriers to cross-border settlement by enhancing coordination and cooperation between authorities involved in the supervision of CSDs. All of the options presented are alternatives.

Policy Option	Description
Option 1: Do nothing (baseline)	This is the baseline scenario (see section 5.1).
Option 2: Enhance the existing CSDR rules for cooperation arrangements	Introduce clarifications to the existing framework for cooperation arrangements that are established between competent authorities of home and host Member States where a CSD is of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State.
Option 3: Introduce mandatory supervisory colleges	Supervisory colleges would be required to enhance the cooperation between different authorities. Elements to be considered are: the CSDs for which the establishment of a college would be required; the composition, e.g. home and host authorities, other relevant authorities; the powers of the college (only information sharing, or consultation/issuance of opinion before the adoption of certain decisions by the home authority (see also next option)).
Option 4: More supervision	ESMA would be granted more supervisory powers in relation to EU CSDs. Several

of CSDs at EU level	aspects would have to be considered, including: scope, i.e. the CSDs over which ESMA could have supervisory powers; the powers granted to ESMA, ranging from participation in colleges (as above), via the need for them to approve all or some decisions of national authorities, to direct supervisory powers.

5.2.3. Restrictive requirements for provision of banking services related to settlement in foreign currencies

The objective is to enhance the cross-border provision of CSD services, through improved access to banking-type services while ensuring financial stability. Options 2 and 3 may be complementary.

Policy option	Description
Option 1 - Do nothing (baseline)	This is the baseline scenario (see section 5.1).
Option 2 – Introduce targeted amendments for banking type services	Clarifications and targeted enhancements would help CSDs to provide cross-border settlement less costly while keeping financial stability risk limited. These could include, (a) removing certain restrictions for designated credit institutions under article 54(4) of CSDR and/or (b) allowing CSDs with a banking license to offer banking services to other CSDs (inside and outside their group).
Option 3 – Amend the threshold below which CSDs can use a commercial bank for banking-type ancillary services.	More flexibility for CSDs to offer services in foreign currencies, depending on the threshold set, while mitigating additional financial stability risks and reducing compliance costs.
Option 4 – Combination of options 2(b) and 3	Amend threshold and broaden the potential banking-services providers by allowing CSDs with a banking license to offer banking services to other CSDs (inside and outside their group).

5.2.4. Unclear and complicated requirements for settlement discipline

The objective is to minimise the burden and compliance costs of the settlement discipline regime, avoid negative impacts on EU capital markets, while ensuring a high degree of settlement efficiency.

Policy option	Description
Option 1 - Do nothing	This is the baseline scenario (see section 5.1).
Option 2 – Introduce targeted amendments for cash penalties and mandatory buy-ins	Amendments could be introduced to both cash penalties and mandatory buy-ins to clarify the rules, e.g. on scope exempting certain instruments, adjusting provisions on the use of buy-in agents[207] and pass-on mechanisms.[208]

[207] The buyer in a securities transaction is obliged to initiate a buy-in process against the seller should the settlement of a transaction fail after a certain period of time. This needs a neutral third-party who acts as a buy-in agent.

[208] Sales in non-cleared markets are contingent on the settlement of an outright purchase of the same security. In some markets, this can create chains of transactions with dependent settlements. As such, a single settlement fail (at the start of the chain) can cause a sequence of settlement fails in the entire chain.

Option 3 – Follow a two-step approach	Initially only cash penalties and reporting requirements would be introduced. If no further improvement in settlement rates is observed, mandatory buy-ins would be introduced.
Option 4 – Introduce voluntary buy-ins	Buy-ins would be made voluntary for some or all asset classes. Rules on cash penalties and reporting requirements would remain.
Option 5 – Targeted amendments combined with a two-step approach	Clarifications with regards to in-scope transactions will apply immediately to cash penalties, while amendments linked to pass-on mechanism and buy-in agents will be deferred until the potential launch of mandatory buy-ins.

The objective is to minimise the burden and compliance costs of the settlement discipline regime, avoid negative impacts on EU capital markets, while ensuring a high degree of settlement efficiency. Options 2, 3, and 4 are complementary, Option 3 and 4 alternative.

5.2.5. Insufficient reporting for third-country CSDs

The objective is to increase information available on third-country CSDs' activities in relation to financial instruments constituted under the law of a Member State to allow authorities in the EU to assess potential risks (see section 2.3.5). Options 2 and 3 may also be complementary whereas Option 4 is an alternative.

Policy option	Description
Option 1 - Do nothing	This is the baseline scenario (see section 5.1).
Option 2 – Introduce an end-date to the grandfathering clause	An end-date to the grandfathering clause would be introduced[209] (e.g. requirement for CSDs to apply for recognition 3 years from entry into force, and/or introduce a maximum period).
Option 3 – Introduce a notification requirement for third-country CSDs	As proposed by ESMA[210], third-country CSDs providing services in the EEA under the grandfathering clause or offering settlement services (for which recognition by ESMA is not required) could be required to notify ESMA of their activity. ESMA could also be able to submit requests for access to information directly to these CSDs. The main information collected by ESMA would be made available to the public.
Option 4 – Enhance the regime for third-country CSDs	The requirements applicable to third-country CSDs would be enhanced. For instance, settlement services could be included within the scope of the ESMA recognition regime and/or ESMA could become a fully-fledged supervisor for third-country CSDs.
Option 5: combination of Options 2 and 3	Introduction of an end-date to the grandfathering clause and a notification requirement for third-country CSDs operating under the grandfathering clause or offering settlement services in relation to financial instruments constituted under the law of a Member State.

5.3. Options discarded at an early stage

Certain options have been discarded at an early stage as inconsistent with the EU legal framework or the objectives of this initiative to ensure a resilient and efficient market for settlement in the EU. These relate in particular to the restrictive requirements for the provision of banking-type ancillary services and the unclear and complicated requirements for settlement discipline.

[209] The end-date to the grandfathering clause would be introduced for both for EEA and third-country CSDs.
[210] ESMA letter to the Commission (see note 133).

Regarding the former, the option to introduce in CSDR a requirement for central banks to facilitate CSDs' access to central bank money was discarded. CSDR should be without prejudice to the independence of central banks, which is enshrined in the TFEU, as concerns their policies on access of domestic or foreign financial market institutions to central banks' accounts and central banks' facilities. Therefore, CSDR is not an appropriate place to impose obligations on the EU central banks.[211]

With regards to the unclear and complicated requirements for settlement discipline the option to suspend the framework in its entirety was discarded. Settlement fails in the EU remain consistently higher than in other major financial markets which affects negatively the standing of EU financial markets as a target of investment and source of financing among EU market participants, while also undermining the international competitiveness of EU financial markets.

Similarly the option to differentiate the settlement discipline regime based on instrument type, market or the existence of a clearing obligation was disregarded for several reasons. First, this would create a two-tier market structure leading to arbitrage risks and investors fleeing to the lighter regulated market. This runs clearly against the objectives of CMU. Second, tougher settlement discipline measures only on the less performing markets will likely drive away any liquidity and trading from these venues undermining financial markets in these Member States while leading to concentration of market activity on a few Union markets. Finally, it could encourage failing market participants to migrate to venues that are not subject to the tougher settlement discipline measures. These effects combined could lead to a two-tier capital market in the EU, with a small number of liquid and efficient markets and a large number of smaller, less liquid and risky national capital markets, undermining the role of financial markets as drivers of growth and economic stability.

6. WHAT ARE THE IMPACTS OF THE POLICY OPTIONS?

This section describes the impact of each policy option against the drivers. In addition, each policy option considered (other than Option 1 (baseline)) will be assessed against the specific objectives presented in Section 4. In essence, under Option 1 (see section 5.1), all problems identified will remain, meaning that inefficiencies and disproportionate costs will remain, to the detriment of the competitiveness of EU financial markets.

For readability and flow of the text, the sections below focus on the effectiveness of each option in meeting the specific objectives, its coherence with the EU framework as well as the rationale for selecting each preferred policy option. A detailed description of the costs and benefits (efficiency) of each option can be found in Annex 7.

6.1. Impact of the policy options regarding passporting requirements

6.1.1. Option 2 - Reduce the scope of the passporting requirements

<u>Effectiveness in meeting the specific objectives</u>

Passporting requirements would not apply for non-equity securities. There would be no need for CSDs to apply for a passport when providing services for these instruments cross-border. This would provide legal clarity (no requirements) for CSDs and national authorities, reducing the administrative burden and compliance costs for both.

[211] CSDR review report (see note 9).

The two specific objectives would however only be partially met, as the problems identified would remain for equities. As such, cross-border settlement activities of CSDs for equities may stagnate or reduce, and the administrative burden for CSDs and national authorities would remain. In addition, as passporting requirements would not apply to non-equity securities, national authorities would not have a clear overview of the services provided for non-equity instruments by CSDs established outside their jurisdiction and the risks that they may or may not entail. This could impact the specific objective to ensure adequate powers and information to monitor risks. Finally, there is no strong justification why two categories of securities should be treated differently.

Coherence

This option ensures that CSDs benefit from a less burdensome passporting process, but only for non-equity securities (and not for equity securities). This is only partly coherent with the objective of CSDR to provide CSDs with the freedom to provide services across the EU. In addition, it is only partially coherent with the CMU Action Plan[212] which favours amendments to the functioning of the CSD cross-border passport in general, and not only for non-equity securities, to contribute to the development of a more integrated post-trading landscape in the EU.

6.1.2. Option 3 - Clarify the role and powers of competent authorities and requirements related to national laws

Effectiveness in meeting the specific objectives

Clarifying the passporting requirements would help CSDs and national authorities to reduce the costs of trying to understand them (e.g. legal opinion, discussions with legal counsel). The requirements will however remain burdensome, in particular those related to national laws. As such, while the specific objective of reducing administrative burden and costs could be partially met through more clarity and thus legal certainty, the specific objective to minimise barriers to cross-border settlement will not.

Coherence

This option would ensure that CSDs benefit from clearer passporting requirements. This would however only in part be coherent with the CMU Action Plan[213] as the content of requirements, in particular those related to national laws, will remain burdensome and, in turn, not fully enhance the functioning of the CSD passport. The CMU Action Plan[214] favours amendments to the functioning of the CSD cross-border passport to contribute to the development of a more integrated post-trading landscape in the EU.

6.1.3. Option 4 - Replace the passporting procedure at the host Member State level with a notification.

Effectiveness in meeting the specific objectives

Replacing the passporting procedure at the host Member State level with a notification procedure would remove that unclear and burdensome passporting requirement. As such, it would meet the specific objectives of reducing administrative burden and costs as well as minimising barriers to cross-border settlement. Option 4 does not waive the obligations stemming from national corporate legislation since harmonisation of the

[212] Commission Communication ‘A Capital Markets Union for people and businesses – New Action Plan’ (see note 10).

[213] Ibid.

[214] Ibid.

corporate laws is not the objective of CSDR and such national corporate legislation applies to participants directly[215]. Furthermore, as a notification procedure will still remain in place, it would ensure that authorities have adequate information to monitor risks. Not only would the host national supervisor be notified of the passport by the home national supervisor (and would have the possibility to discuss it with the home national supervisor during and after the passporting procedure), but the former would also potentially be able, through the establishment of colleges (see Section 6.2.2) to have a better overview of the supervision of the CSD on an ongoing basis, better cooperate and raise its concerns with the home national supervisor.

Finally, Option 4 is aligned with the status of one of the main core services, settlement, for which no passport process is currently required.[216]

<u>Coherence</u>

This option is fully coherent with the CMU Action Plan[217] which favour amendments to the functioning of the CSD cross-border passport that could contribute to the development of a more integrated post-trading landscape in the EU. It is also consistent with the aim of EU regulation, i.e. harmonising laws for Member States, and removing barriers stemming from national laws.

6.1.4. Option 5 – combination of Option 3 and Option 4

<u>Effectiveness in meeting the specific objectives</u>

Combining Option 3 and Option 4 would allow to meet both of the following specific objectives: (i) reducing administrative burden and costs through more clarity and thus legal certainty and (ii) minimising barriers to cross-border settlement.

<u>Coherence</u>

This option would ensure that CSDs benefit from clearer passporting requirements and is fully coherent with the CMU Action Plan[218] which favours amendments to the functioning of the CSD cross-border passport to contribute to the development of a more integrated post-trading landscape in the EU. Finally, it is consistent with the aim of EU regulation, i.e. harmonising laws for Member States, and removing barriers stemming from national laws.

6.1.5. Choice of preferred policy option

The tables below provide a high-level summary of how the described options compare (for the sake of readability, the labels of the options have been shortened). For a detailed overview of the costs and benefits (efficiency) of each option and impacts on different stakeholders see Annex 7.

Option 2 would only partially satisfy the objectives of minimising barriers to cross-border settlement and of reducing administrative burden and costs, as the alleviations would apply only to non-equity securities and not to equity securities. Option 3 is also

[215] It stems from the combined reading of Articles 23 and 49(1) of CSDR that it is the responsibility of the participants to comply with the relevant national legislation. The proposed policy options do not contemplate any change in this respect.

[216] Article 23(2) of CSDR.

[217] Commission Communication 'A Capital Markets Union for people and businesses – New Action Plan' (see note 10).

[218] Commission Communication 'A Capital Markets Union for people and businesses – New Action Plan' (see note 10).

only partially meeting the objectives as it only addresses the lack of clarity and not the burdensome nature of the requirements. Option 4 would meet these specific objectives.This option would be consistent as it would focus on a core aim of EU regulation, i.e. mutual recognition. **Option 5**, which is the preferred policy option, would combine the benefits from Option 3 and Option 4.

	Effectiveness			Efficiency (cost-effectiveness)	Coherence
	Minimise barriers to cross-border settlement	Ensure adequate powers and information to monitor risks	Reduce administrative burden and costs		
Option 1 – *baseline scenario*	0	0	0	0	0
Option 2 – *Reduce scope of the passporting requirements*	+	-	+	+	+
Option 3 – *Clarify uncertainties*	-	+	+	+	+
Option 4 – *Replacing passporting procedure at the host Member State level with a notification*	+++	+/-	+++	+++	+++
Option 5 – Combination of Option 3 and Option 4	+++	+	+++	+++	+++

		Summary of winners and losers		
	CSDs	Issuers	Investors	Supervisory authorities
Option 1	0	0	0	0
Option 2	+	+	+	-
Option 3	+	+	+	+
Option 4	+++	+++	+++	+/-
Option 5	+++	+++	+++	+/-

Legend: +++ = Very positive ++ = Positive + = Slightly positive +/- = Mixed effect **0** = no effect **-** = Slightly negative **--** = Negative **---** = very negative

6.2. Impact of the policy options regarding cooperation between authorities

6.2.1. Option 2: Enhance the existing CSDR rules for cooperation arrangements

Effectiveness in meeting the specific objectives

Clarifications to the existing framework for cooperation arrangements would be introduced in certain cases, i.e. when a CSD is operating cross-border. These **would partly meet the objective of minimising barriers to cross-border settlement and ensuring adequate powers for authorities to monitor risks** for several reasons:

- cooperation arrangements are established bilaterally, i.e. if a CSD is of substantial importance to more than one host Member State, then the home authority needs multiple cooperation arrangements. This leads to duplication and an increased administrative burden for the home national authority, who would have to negotiate and manage multiple parallel cooperation arrangements;

- cooperation arrangements are established for a limited number of CSDs. The problems identified in Section 2.2.1 for all other cases for CSDs and national authorities would therefore remain;
- ESMA does not participate in CSDR cooperation arrangements, which means that it cannot be ensured that a similar approach will be adopted by all such arrangements. Even if the framework was amended to provide that ESMA does participate, it would not have the guarantees provided by the ESMA Regulation.

<u>Coherence</u>

This option is coherent with the current CSDR framework, as it builds on the already foreseen arrangements. However, it is partly coherent with the CMU Action Plan,[219] which highlights the need to develop a more integrated post-trading landscape in the EU and states that if there are indications that the supervisory set-up is inadequate, stronger supervisory coordination or direct supervision by the ESAs should be considered. Furthermore, this option is not coherent with the ESMA Regulation, which already foresees a specific framework for the cooperation of supervisors in Article 21.

6.2.2. Option 3: Introduce mandatory supervisory colleges

<u>Effectiveness in meeting the specific objectives</u>

Under Option 3, supervisory colleges would be established for some or all EU CSDs, depending on the design of the framework. In general, the experiences with colleges in other EU financial frameworks are positive and colleges are genuinely seen as a forum where authorities with direct interest in the activities of a financial market infrastructure gather and exchange views. As such, colleges are already enshrined in the ESMA Regulation and for example put to practice in the context of EMIR for CCPs.

To meet the specific objectives of minimising barriers to cross-border settlement and ensuring adequate powers to monitor risks, colleges could in particular be established for CSDs offering services in relation to financial instruments constituted under the law of another Member State as well as CSDs that are part of corporate groups that include at least another CSD. Participation to these colleges could be reserved for authorities that have an interest in those CSDs' operations, e.g. the CSDs' home and relevant authorities, the host competent and relevant authorities in the case of CSDs that operate cross-border, other CSDs' competent and relevant authorities in the case of CSDs that are part of a group of CSDs as well as the EBA, where a CSD has been authorised to provide banking-type ancillary services.

This option would partly, but more than Option 2, meet the aforementioned specific objectives of this initiative. The main reasons for this are twofold.

First, while colleges would be set up primarily for information-sharing purposes and the home supervisor would maintain supervisory powers, the input of other authorities participating to colleges would be taken more into account through their participation in colleges, compared to under cooperation arrangements (which are only applicable where a CSD is of substantial importance to another Member State). The involvement of other authorities through the college will strengthen the passport effect and enhance the cooperation of supervisors and relevant authorities for groups of CSDs, as barriers related to lack of trust and/or sharing of information are reduced.

[219] Commission Communication 'A Capital Markets Union for people and businesses – New Action Plan' (see note 10).

Second, ESMA's role would be strengthened, as it would participate in all colleges and have all the powers entrusted to it under the ESMA Regulation. This would ensure consistency across colleges, it would allow the centralisation of supervisory information, the earlier identification of issues linked to CSDR implementation (compared to now, where ESMA is only aware of issues when raised by national supervisors or market participants) and the building of a common supervisory culture across EU CSDs. By increasing cooperation between all authorities involved in the supervision of CSDs, this option allows for a more holistic approach which more adequately responds to the increasingly systemic nature of these infrastructures within the EU financial system. In addition, ESMA would be able to build up its supervisory competence in this field.

Colleges would ensure that while supervisory responsibilities are aligned, a more coherent application of CSDR in the EU is guaranteed and the current supervisory arrangements are more effective. Nonetheless, this option does not completely eliminate the possibility for potential divergences in the application of CSDR in the EU.

Coherence

This option is coherent with the CMU Action Plan,[220] which highlights the need to develop a more integrated post-trading landscape in the EU and states that if there are indications that the supervisory set-up is inadequate for the desired level of market integration, stronger supervisory coordination or direct supervision by the European Supervisory Authorities should be considered. In addition, it is coherent with the ESMA Regulation, which already foresees in Article 21 a specific framework for the cooperation of supervisors through the establishment of colleges of supervisors.

6.2.3. Option 4: More supervision of CSDs at EU level

Effectiveness in meeting the specific objectives

Under this option, a single supervisor would be established for CSDs. The single supervisor could be ESMA, the ECB, or a new entity as was the case for the Single Supervisory Mechanism (SSM) in the field of banking. Depending on the exact design, the single supervisor would be given full responsibility for the supervision of all or certain CSDs in the EU, including powers to authorise CSDs and oversee compliance with conduct of business rules. In performing these tasks, it would be required to cooperate closely with other bodies, such as the ESCB, as well as the ESAs. However, none of these authorities would have binding powers over the single supervisor.

This option would eliminate barriers to the cross-border provision of services (as CSDs would be authorised and supervised at EU level) and ensure a coherent application of CSDR within the EU, addressing effectively the need for supervisory convergence.

However, it should be noted that some CSDs in the EU are already exempt from certain CSDR requirements,[221] therefore it is not clear whether they would be able to be subject

[220] Commission Communication 'A Capital Markets Union for people and businesses – New Action Plan' (see note 10).

[221] Article 1(4) of CSDR stipulates that Articles 10 to 20, 22 to 24 and 27, Article 28(6), Article 30(4) and Articles 46 and 47, the provisions of Title IV and the requirements to report to competent authorities or relevant authorities or to comply with their orders under this CSDR, do not apply to the members of the ESCB, other Member States' national bodies performing similar functions, or to other public bodies charged with or intervening in the management of public debt in the Union in relation to any CSD which the aforementioned bodies directly manage under the responsibility of the same management body, which has access to the funds of those bodies and which is not a separate entity.

to supervision by an EU body. In addition, no EU body has substantial supervisory experience over CSDs now in order to be able to be immediately operational.

It is worth noting that the main advantages and disadvantages of moving supervision of EU CSDs at EU level are broadly the same regardless of whether EU supervision is exercised over all or a subset of EU CSDs.

Coherence

This option is coherent with the CMU 2020 Action Plan,[222] which highlights the need to develop a more integrated post-trading landscape in the EU and states that if there are indications that the supervisory set-up is inadequate for the desired level of market integration, stronger supervisory coordination or direct supervision by the European Supervisory Authorities should be considered. In addition, it is coherent with the approach followed in the case of other financial institutions for which ESMA has already been granted either a role in their supervision through its participation in colleges (e.g. for CCPs) or direct supervisory powers (for credit rating agencies and trade repositories).

6.2.4. Choice of preferred policy option

The tables below provide a high-level summary of how the described options compare (for the sake of readability, the labels of the options have been shortened). For a detailed overview of the costs and benefits (efficiency) of each option and impacts on different stakeholders see Annex 7.

In view of the high political priority of the review to facilitate CSDs' access to markets other than that of their authorisation as well as ensure financial stability by providing supervisors with more powers to monitor risks, **Option 3 is deemed more appropriate and proportionate** for the following reasons: first, it attains the right balance between achieving the aforementioned objectives and Member States' responsibilities; second, it reflects the fact that ESMA does not currently have experience in the supervision of CSDs and gives it time to build up its supervisory capacity; third, it is the most cost-effective option at this point in time (see Annex 7 on the costs colleges and EU level supervision would entail for all interested stakeholders).

	Effectiveness			Efficiency (cost-effectiveness)	Coherence
	Minimise barriers to cross-border settlement	Ensure adequate powers and information to monitor risks	Reduce administrative burden and costs		
Option 1 – baseline scenario	0	0	0	0	0
Option 2 –Enhance cooperation arrangements	+	+/-	+	+/-	+/-
Option 3 – Establish colleges	++	++	++	++	++
Option 4 – EU supervision	+++	+++	+/-	--	+++

Summary of winners and losers				
	CSDs	Issuers	Investors	Supervisory authorities
Option 1	0	0	0	0

[222] Commission Communication 'A Capital Markets Union for people and businesses – New Action Plan' (see note 10).

Option 2	+/-	+/-	+/-	+/-
Option 3	++	++	++	+
Option 4	++	+++	+++	--

Legend: +++ = Very positive ++ = Positive + = Slightly positive +/- = Mixed effect **0** = no effect **-** = Slightly negative **--** = Negative **---** = very negative

6.3. Impact of the policy options regarding provision of banking services related to settlement in foreign currencies

6.3.1. Option 2: Introduce targeted amendments for designated credit institutions

Effectiveness in meeting the specific objectives

Targeted amendments would be made to the regime for the provision of banking-type ancillary services. Financial stability considerations led to strict rules to limit the liquidity and credit risks incurred by CSDs. As outlined in section 2.3.3, these requirements mean that no designated credit institution exists and compliance costs limit foreign currency settlement as banking CSDs are unable to offer services to non-banking CSDs even within their group. Targeted amendments could consist of removing some restrictions for designated credit institutions, allowing more banks to provide these services (Option 2a), or allowing CSDs authorised to provide banking services to offer CSD services (e.g. within their corporate group of companies) (Option 2b).

For both options, cross-border settlement would improve as options for CSDs will increase, providing issuers and investors with more opportunities and choice. In addition, economies of scale could be more easily reached, increasing the attractiveness for new CSD entrants in this market, in particular those based on new technologies. This would also be consistent with the CMU Action Plan aiming for more integrated post-trade markets and enhanced capital markets in the EU, as well as efforts to promote new technologies.

Financial stability risks would however increase as credit and liquidity risks could rise. This would be the case for both options 2a and 2b. For Option 2b, concentration risk would increase as exposures would be concentrated in the, at present, five CSDs that have been authorised to provide banking-type ancillary services including within groups of CSDs. Nevertheless, the potential wider risks for financial stability would potentially be greater for Option 2a as the risk of contagion to the wider banking sector would be larger. In addition, credit institutions would not be subject to the additional capital surcharge that CSDs are under CSDR, further amplifying the potential risks for the banking sector. Nevertheless, for both options, it is unsure whether and if yes, to what extent, the market will make use of the additional opportunities, which in particular, is especially true for Option 2a where the market cannot benefit from existing established structures, such as they could in Option 2b.

Coherence

The option to partially or completely remove restrictions for the designated credit institution is not coherent with the current CSDR framework, as it will introduce possibly unlimited risk into the financial system, whereas 2b could introduce more risks but within the current arrangements of CSDR. At the same time, Option 2a could bring further risks as potentially a greater level of risk could spread beyond CSDs to the wider banking system, when compared to 2a. Both 2a and 2b are however, coherent with the CMU 2020 Action Plan, which highlights the need to develop a more integrated post-trading landscape in the EU and aims to improve cross border transactions within the EU.

Option 2b is relatively better than 2a in this respect. Both sub-options are coherent with existing banking regulations as they will continue to apply on the CSDs in this option.

6.3.2. Option 3: Amend the thresholds under which CSDs can use a commercial bank for banking-type ancillary services.

Effectiveness in meeting the specific objectives

Under this option targeted amendments would be made to the threshold for CSDs (currently maximum of 1% of total assets and EUR 2.5 billion) to provide ancillary banking services. This would make the provision of these services less burdensome and, due to lower compliance costs, economies of scale for the provision of settlement in foreign currencies could be more easily achieved. Achieving these economies of scale would also facilitate CSDs to transition to settlement of foreign currencies in central bank money (one of CSDR's aims) by enabling them to reach appropriate economies of scale to justify connecting to the relevant central bank. This would help make cross-border transactions more available to investors against a minimum of compliance costs for CSDs. The price for this is in terms of financial stability risks, since credit and liquidity risks of the CSD could potentially increase, could be mitigated by increased supervisory monitoring by the relevant banking authority. Changing the thresholds would also help improve the efficiency of settlement markets as competition in settlement in foreign currencies will increase and current settlement arrangements can remain in place for CSDs.

Coherence

This option is coherent with the current CSDR framework, as it builds on the already foreseen arrangements. It is also coherent with the CMU Action Plan,[223] which highlights the need to develop a more integrated post-trading landscape in the EU and aims to improve cross-border transactions in the EU while preserving financial stability. It is also coherent with banking regulations in taking financial stability as a starting point. Option 3 does not entail a big change to CSDR's requirements which is positive. It will increase cross-border provision of settlement services as compliance costs are limited to internal operational risk processes and external compliance costs are limited. It could be relatively simple to apply as the prudential framework already covers the additional risks.

6.3.2. *Option 4: Amend the thresholds under which CSDs can use a commercial bank for banking-type ancillary services and allow banking CSDs to provide services.*

Effectiveness in meeting the specific objectives

The combination of options 2(b) and 3 will help achieve the specific objectives of increasing cross-border settlement and efficiency of the provision of banking services as well as reducing administrative costs, as elaborated under options 2 and 3, in a more comprehensive manner than what could be achieved by applying only one of these options. A combination of options 2(b) and 3 would have as an additional benefit as compared to the above. While reviewing the threshold for banking services would potentially increase the notional amounts available for banking services (including foreign currency settlement) in EU settlement markets, including banking CSDs into the potential providers of these services would increase potential notional amounts available for foreign currency even further through broadening the range of providers.

[223] Commission Communication 'A Capital Markets Union for people and businesses – New Action Plan' (see note 10).

Coherence

The combination of options 2(b) and 3 is coherent with EU policies, such as the objective of CMU to create a more integrated post-trading landscape in the EU contributing to the EU internal market as elaborated in the respective sections.

6.3.3. Choice of preferred policy option

The tables below provide a high-level summary of how the described options compare (for the sake of readability, the labels of the options have been shortened). For a detailed overview of the costs and benefits (efficiency) of each option and impacts on different stakeholders see Annex 7.

In view of the political priority of CMU and to create a single European market for capital, improving possibilities for CSD to offer settlement in foreign currencies adds to the aim of this review to facilitate CSDs' access to other markets other than their home market and minimise cross-border barriers. At the same time, this should be done while preserving financial stability and keeping settlement markets safe. **Hence, and since not mutually exclusive, a combination of options 2b and 3 are deemed more appropriate and proportionate** (Option 4) in attaining the right balance between achieving the aforementioned objectives.

	Effectiveness			Efficiency (cost-effectiveness)	Coherence
	Minimise barriers to cross-border settlement	Ensure adequate powers and information to monitor risks	Reduce administrative burden and costs		
Option 1 – baseline scenario	0	0	0	0	0
Option 2a –Targeted Amendments- Remove restrictions	++	+	+	-	--
Option 2b –Targeted Amendments-allow banking CSDs to offer services to other CSDs	++	+	+	++	++
Option 3 – Amend threshold	+++	+	+++	+++	++
Option 4 – combination of 2(b) and 3	+++	+	+++	+++	++

	Summary of winners and losers			
	CSDs	Issuers	Investors	Supervisory authorities
Option 1	0	0	0	0
Option 2a	+	+	+	--
Option 2b	++	++	++	0
Option 3	++	+++	+++	+
Option 4	++	+++	+++	+

Legend: +++ = Very positive ++ = Positive + = Slightly positive +/- = Mixed effect**0** = no effect **-** = Slightly negative **--** = Negative **---** = very negative

6.4. Impact of the policy options regarding settlement discipline

6.4.1. Option 2 – Introduce targeted amendments for cash penalties and mandatory buy-ins

Effectiveness in meeting the specific objectives

This option includes amendments that would simplify elements of the settlement discipline regime, e.g. with regards to the pass-on mechanism, in-scope transactions and buy-in agents. These changes would be limited, introduced only in areas where the regime would benefit from minor corrections or amendments.

First, amendments to the pass-on mechanism would allow to solve all settlement fails along the same chain by one buy-in in the original settlement fail which provoked the other fails. This would be combined with measures to address the rigidness in timing of when a buy-in is initiated and the asymmetry in price differentials.[224] This would reduce the complexity and the burden of managing a buy-in process.

Second, certain transactions may no longer be subject to the settlement discipline regime, e.g. corporate actions on stock (e.g. initial creation transactions and redemptions), certain central bank transactions (e.g. monetary policy operations which are not credit operations[225]), and certain other transactions (e.g. auto-generated transactions by CSDs)[226]. In addition to mandatory buy-ins, certain transactions could be exempted from the cash penalties regime. These changes would permanently reduce the compliance burden on market participants by removing transactions that do not form part of market turnover or lie outside their control. Compliance costs for regulators, i.e. replying to Q&As, will also be reduced permanently. Furthermore these amendments would reduce the number of settlement fails and improve settlement efficiency.

Third, more choice could be enabled as concerns buy-in agents, i.e. appoint a broader range of actors as buy-in agents. A major concern for many stakeholders[227] is that so far only one service provider has emerged with a buy-in solution and that the offer is not consistent with the needs of all stakeholders[228]. Subject to best execution requirements and clearly defined limitations and conflicts of interest,[229] firms could be able to execute their own buy-ins. Buy-ins already exist today without a buy-in agent, e.g. at CCPs, many of which do not use a buy-in agent but go to auction, sourcing the liquidity from their network on a best execution basis. Allowing parties, within limits to execute their own buy-ins based on underlying contractual requirements, could allow flexibility to act in the best economic interest of the non-receiving party and tailor buy-ins to the characteristics of different types of financial instruments.

Such amendments would effectively and permanently reduce administrative burden and compliance costs. In particular clarifications with regards to in-scope transactions would effectively reduce complexity, administrative burden and compliance costs for all market participants. Furthermore, fewer buy-ins would improve settlement efficiency.

Coherence

This option would be coherent with the overall objectives of CMU, as well as specific objectives of CSDR. It would also be coherent with the REFIT initiative to have proportionate requirements in that it would permanently lessen to a certain extent the administrative burden and compliance costs for investors, CSDs and regulators without endangering financial stability. These benefits would be long-term.

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[224] Responses to the Commission CSDR targeted consultation by ICMA (see note 198), ISLA (https://www.islaemea.org/wp-content/uploads/2019/03/ISLA_Response_EC_Targeted_Consultation_CSDR.pdf), AFME (see note 127).

[225] Currently these would include outright operations conducted under the Eurosystem's Asset Purchase Programme or the Pandemic Emergency Purchase Programme, and the associated securities lending transactions. Based on confidential information provided to DG FISMA services.

[226] Responses to the CSDR targeted consultation by ECSDA (ESCDA response to the Commission CSDR targeted consultation, https://ecsda.eu/archives/13474), Clearstream (see note 190), Euronext (see note 106), Q. 33.2.

[227] Summary Report of the Commission CSDR targeted consultation (see note 92).

[228] It is claimed that the legal structure of the buy-in agent and its collateral requirements are more suitable for banking customers. Based on confidential information provided to DG FISMA services.

[229] Article 24 of the RTS on settlement discipline.

The negative market impacts of this option would be similar to Option 1, and would be related to the introduction on the mandatory buy-in. The clarifications contained in Option 2 would not considerably diminish their negative market impacts.

6.4.2. Option 3 – Introduce a two-step approach

Effectiveness in meeting the specific objectives

Under this option cash penalties would apply immediately, while the implementation of mandatory buy-ins would be deferred and triggered only where necessary, if the other settlement discipline measures (i.e. reporting and cash penalties) prove to be insufficient to achieve an acceptable level of settlement efficiency within the Union. Any delay in the application of mandatory buy-ins should apply equally to the full market (i.e. both the cleared and uncleared space) to prevent an unlevel playing field. This is essential to avoid an unintended shift of trading volumes to a non-cleared environment, notably for less liquid securities. The monitoring and reporting obligations under CSDR and the relevant RTS will remain unchanged.[230]

Under the two-step approach it would therefore first need to be determined, following a granular analysis of the fails in the EU settlement market and at international level, where the main settlement fails occur, at which level and for which reasons. ESMA could be required to produce on a regular basis (e.g. every two years) a report on settlement fails in the market that would focus, amongst others, on the levels of fails and their evolution, the underlying drivers, the main instruments affected, an international comparison of settlement fail rates, as well as assess whether cash penalties remain a proportionate and effective tool to address these fails. The entry into application of the mandatory buy-in regime could be left to a Level 2 act to be adopted by the Commission, taking into account, where available, ESMA's report.

This option will be effective in addressing one of the main reasons for settlement fails, i.e. insufficient capacity among market participants for post-trade functions. Practical experience from other capital markets[231] suggests that cash penalties may provide sufficient incentive for the necessary capacity improvements to address settlement fails. Furthermore, these improvements will particularly benefit the processing of smaller trades which are more prone to fail. While encouraging improved settlement, this option allows to avoid the most negative impacts of mandatory buy-ins related to liquidity, bid-ask spreads or market stability. It will also discourage strategic behaviour by counterparties. Cash penalties, like positive interest rates, will be an incentive for the selling party to source the securities, whether outright or in repo (particularly when the penalty is more punitive than the repo rate for the security). Furthermore, in the absence of mandatory buy-ins, alternatives will be available to the buyer to initiate a buy-in

[230] Articles 13 and 14 of the RTS on settlement discipline.

[231] The US experience shows that the introduction of a 'fail charge' for US Treasury Securities reduced fails significantly. On 12 November 2008, the Treasure Market Practices Group (TMPG) published their recommendations to introduce a fails charge (known as the 'TMPG fails charge'), which went live on 1 May 2009. Studies showed that the anticipation of the implementation of the rule had a significant effect on settlement fails. A paper published in the 'FRBNY Economic Policy Review/ October 2010' states that "*primary dealer fails declined from a daily average of $379 billion during the week of October 16-2 to a daily average of $70 billion during the week of November 13-19 and averaged less than $50 billion a day in December*". The paper also shows that fails averaged just over $14.4 billion per day during the first four months of 2009, but only $4.2 billion per day since the implementation of the fails charge. Based on: 'The introduction of the TMPG fails charge for U.S Treasure Securities', Federal Reserve Bank of New York (FRBNY), Economic Policy Review/ October 2010.

against a failing seller: cash compensation, bilateral cancellation or to extend the delivery time to a date when the seller can make the delivery which will ensure that the buyer receives the securities and not a cash settlement. Buy-in arrangements are usually a standardised process and are incorporated in the terms of business between counterparties, to cover specific markets. Lastly, this option will minimise the pro-cyclical effects as they are related to buy-ins rather than cash penalties.[232] The main costs of this approach is setting the conditions that would justify the introduction of mandatory buy-ins as a second step of the two-step approach.

Coherence

This option would be coherent with the objectives of CMU and CSDR as it would provide the necessary incentives to further improve EU settlement efficiency. It would also be coherent with the REFIT initiative as it would better comply with the principle of proportionality in that, to the extent that cash penalties can enhance on their own settlement efficiency, the application of additional measures (i.e. mandatory buy-ins) would go beyond what is necessary to achieve the pursued objectives. Concerns related to market stability or the ability of market participants to fulfil certain functions, such as market making, would not materialise.

6.4.3. Option 4 – Introduce voluntary buy-ins

Effectiveness in meeting the specific objectives

Under this option cash penalties would be mandatory while buy-ins would be voluntary. Even if buy-ins would be voluntary, all EU investment firms would need to put in place contractual arrangements for buy-ins with their relevant counterparties. The monitoring and reporting obligations under CSDR and the relevant RTS would remain unchanged.[233]

The decision to initiate a buy-in would be the discretionary right of the purchasing party giving it more flexibility in achieving its investment objectives. This will apply in relation to both transactions with and without the involvement of a CCP in order not to incentivise migration of trading to non-cleared markets and indirectly undermine a key EU policy objective in financial markets. In order for voluntary buy-ins to be effective a number of high-level principles[234] could be developed in CSDR. To ensure their clients' access to voluntary buy-ins, market participants could still need to enter into a re-papering exercise, similar in scope and cost to the described under Option 3. There are also doubts about the use of and effectiveness of voluntary buy-ins to reduce settlement fails. In markets dominated by large dealers, investors may be discouraged from adopting buy-ins for fear of retaliation[235]. There is evidence that buy-ins are currently rarely used as a voluntary contractual arrangement between market participants.[236] Already today, the trading parties have the right to request buy-ins, whether through market standards (ICMA rules), legal standards (stock exchange regulations) or contractual rights.

[232] The potential for a buy-in impacts the starting bid-offer spread and its impact will be pro-cyclical, i.e. when liquidity reduces, the price increase due to the buy-in will be greater further reducing trading activity and thus liquidity.

[233] Articles 13 and 14 of the RTS on settlement discipline.

[234] For instance, the ICMA response to the Commission CSDR targeted consultation reply suggests that the following principles should form part of a voluntary buy-in: (i) the contractual right for the failed-to party to initiate a buy-in, (ii) ability to recover costs incurred in executing the process, (iii) ensuring that the non-failing party is restored to the equivalent economic position and (iv) providing for a cash settlement alternative (see note 198).

[235] Reply to the Commission targeted consultation by Clearstream, Q. 34.1 (see note 190).

[236] Reply to the Commission targeted consultation by Clearstream, Q. 34.1 (see note 190).

However, that is hardly practiced. Hence, voluntary buy-ins do not seem efficient in ensuring settlement efficiency.

Coherence

This option is partly coherent with the objectives of CMU and CSDR as it will provide incentives to further improve settlement efficiency in the form of cash penalties. It contains major disadvantages in the form of increased compliance costs for traders who will need to keep in place a system allowing them to carry out buy-ins if contractually agreed. It opens the possibility for abusive market practices as firms may be discouraged from applying buy-ins if it will hurt established trading relationships. This option is also not proportional. Due to their voluntary nature and evidence so far buy-ins will remain unused, although market participants would incur re-papering costs and regulators face compliance costs related to clarifications and guidance.

6.4.4. Option 5 – Combination of targeted amendments to settlement discipline regime with a two-step implementation of cash penalties and mandatory buy-ins

Effectiveness in meeting the specific objectives

The combination of Option 2 and Option 3 will help achieve the specific objective of reducing administrative burden and compliance costs without endangering financial stability, as explained in sections 6.4.2 and 6.4.3, more comprehensively than each option individually by targeting both procedural aspects of the regime (Option 2) and market impacts (Option 3).

Coherence

The combination of Option 2 and Option 3 is coherent with the objectives of CMU and CSDR as it would provide the necessary incentives to further improve EU settlement efficiency (Option 3). It would also be coherent with the REFIT initiative as it would better comply with the principle of proportionality (Option 3) and reducing administrative burden (Option 2), by introducing clarifications and simplifications to the operation of the settlement discipline regime.

6.4.5. Choice of preferred policy option

The tables below provide a high-level summary of how the described options compare (for the sake of readability, the labels of the options have been shortened). For a detailed overview of the costs and benefits (efficiency) of each option and impacts on different stakeholders see Annex 7.

In view of the importance attached by CMU to safe and efficient financial markets Option 3 offers the most effective, efficient and coherent approach. Thanks to cash penalties it will support improvements in settlement efficiency, without however endangering stability and liquidity across markets and financial instruments. It is more effective in addressing this objective than Option 4, which will have greater negative impacts on market stability, liquidity and pricing while compliance costs for market participants and regulators will be similar to Option 3. The effects of a voluntary buy-in will be similar to the ones described under Option 1, although they may be smaller as buy-ins will not be applied consistently by market participants. The targeted amendments (Option 2) will bring benefits irrespective of the chosen settlement regime in terms of effectiveness, efficiency or lower compliance costs. Hence it can be combined with either Option 3 or Option 4. The benefits will however be greatest when combined with Option 3. Settlement efficiency will improve thanks to cash penalties, which will themselves benefit from clarifications, while mandatory buy-ins will be delayed and also further refined. Hence the preferred policy option is Option 5 (combination of Options 2 and 3) and it will ensure the proportionality and efficiency of the Settlement Discipline Regime.

	Effectiveness			Efficiency *(Cost-effectiveness)*	Coherence
	Minimise barriers to cross-border settlement	Ensure adequate powers and information to monitor risks	Reduce administrative burden and costs		
Option 1 – Baseline scenario	0	0	0	0	0
Option 2 –Targeted amendments	0	0	+++	+++	++
Option 3 – Two-step approach	0	0	++	++	++
Option 4 – Voluntary buy-ins	0	0	-	-	+/-
Option 5 – Two-step approach with targeted amendments	0	0	+++	+++	++

		Summary of winners and losers		
	CSDs	Issuers	Investors	Supervisory authorities
Option 1	0	0	0	0
Option 2	+	++	+++	++
Option 3	+	+/-	++	++
Option 4	-	-	++	--
Option 5	+	++	++	++

<u>Legend</u>: +++ = Very positive ++ = Positive + = Slightly positive **+/-** = Mixed effect**0** = no effect **-** = Slightly negative **--** = Negative **---** = very negative

6.5. Impact of the policy options regarding third-country CSDs

6.5.1. Option 2 – Introduce an end-date to the grandfathering clause

<u>Effectiveness in meeting the specific objectives</u>

Introducing an end-date to the grandfathering clause would ensure that third-country CSDs currently operating under the grand-fathering clause are subject to equivalent rules.[237] It would therefore help ensure a more level playing field between EU authorised CSDs (complying with CSDR) and third-country CSDs when they both operate in the EU. In that sense, and compared to Option 1, it would ensure adequate powers and information to monitor risks for issuers, as third-country CSDs would be forced to apply rules that are at least equivalent.

<u>Coherence</u>

This option is coherent with the aim of a grandfathering clause, which is to provide time for entities to adapt to a new situation created by the CSDR. In this case, CSDR entered into force in 2014.[238] Both EU CSDs and non-EU CSDs have had sufficient time to adapt to CSDR. In addition, this option would contribute to a level playing field between EU and third-country CSDs and therefore contribute to create a more integrated post-trading landscape in the EU as aimed for by the new CMU Action Plan.[239]

[237] The end-date to the grandfathering clause would be introduced for both for EEA and third-country CSDs.
[238] NB: CSDR was included in the EEA Agreement on 1 January 2020.
[239] Commission Communication 'A Capital Markets Union for people and businesses – New Action Plan' (see note 10).

6.5.2. *Option 3 – Introduce a notification requirement for third-country CSDs*

Effectiveness in meeting the specific objectives

Third-country CSDs would have to notify to ESMA when they are providing services in the EU. It would therefore help authorities (but not only) to have more information on their activities and to identify and monitor any potential risks. Options 2 and 3 are not mutually exclusive: Option 3 helps achieve the specific objective of ensuring adequate powers and information to monitor risks from an EU authorities' point of view whereas Option 2 helps the same specific objective also from an investors'/issuers' perspective. These two options could therefore be complementary.

Coherence

This option is coherent with the REFIT initiative to have proportionate requirements. While authorities have very little information on which third-country CSDs operate in the EU, a notification process would help to get this information. It would be coherent with the CMU objective to have a more integrated post-trading landscape in the EU as EU authorities would have more information on which CSDs operate in the EU and therefore more information to monitor potential risks.

6.5.3. *Option 4 – Enhance the regime for third-country CSDs providing services*

Effectiveness in meeting the specific objectives

A more comprehensive third-country regime either requiring ESMA recognition for the provision of all CSD services by third-country CSDs (i.e. also for settlement services) and/or ESMA supervision over third-country CSDs similar to that exercised over third-country CCPs under EMIR (e.g. exercise of supervisory powers over all or certain third-country CSDs) would ensure that adequate powers and information to monitor risks are available at EU level. However, taking into account that: (a) very little information is available as to whether and to what extent third-country CSDs provide services in relation to financial instruments constituted under the law of a Member State; and (b) the increased costs these options would imply for ESMA, the introduction of an enhanced regime for third-countries CSDs does not seem proportionate now. Only the specific objective to ensure adequate powers and information to monitor risks seems to be significantly met with Option 4.

Coherence

This option is coherent with the Parliament Resolution on CMU[240] where it calls to consider gradually granting ESMA direct supervisory powers, including direct oversight over certain market segments such as CSDs. This option is also coherent with the ESMA Regulation[241] that requires the conduct of a comprehensive assessment of the potential supervision of third-country CSDs. However, having done this assessment, it seems that it could be deemed excessive to require third-country CSDs to be subject to a new enhanced third-country regime while authorities do not even know how many operate in the EU and the volume of settlement it concerns. Due to this lack of proportionality, this option would therefore not be coherent with the REFIT initiative.

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

[241] Article 81(2c) of the ESMA Regulation.

6.5.4. Option 5 – combination of Options 2 and 3

Effectiveness in meeting the specific objectives

The combination of Options 2 and 3 will help achieve the specific objectives of ensuring adequate information and powers to monitor risks as well as reducing administrative costs, as elaborated under Sections 6.5.1 and 6.5.2, in a more comprehensive manner than what could be achieved by applying only one of these options.

Coherence

The combination of Options 2 and 3 is coherent with a broad range of EU policies, i.e. the REFIT nature of this initiative, the objectives of the CMU to create a more integrated post-trading landscape in the EU as well as the rationale behind the introduction of the grandfathering clause in CSDR, as elaborated in Sections 6.5.1 and 6.5.2.

6.5.5. Choice of preferred policy option

The tables below provide a high-level summary of how the described options compare (for the sake of readability, the labels of the options have been shortened). For a detailed overview of the costs and benefits (efficiency) of each option and impacts on different stakeholders see Annex 7.

Option 5 (i.e. the combination of Options 2 and 3) is the preferred option. Option 2 would ensure adequate powers and information to monitor risks, as third-country CSDs would be forced to apply rules at least equivalent. Option 3 would help to meet the specific objective of ensuring adequate powers and information to monitor risks for EU authorities. As the number of third-country CSDs is unknown and thus whether there is an issue for financial stability or not, Option 4 is premature and disproportionate.

	Effectiveness			Efficiency (cost-effectiveness)	Coherence
	Minimise barriers to cross-border settlement	Ensure adequate powers and information to monitor risks	Reduce administrative burden and costs		
Option 1 – *Baseline scenario*	0	0	0	0	0
Option 2 – *Introduction of an end-date to the grand-fathering clause*	0	++	++	++	+++
Option 3 – *Introduction of a notification requirement for third-country CSDs*	0	+++	+/-	++	+++
Option 4 – *Enhanced CSDR third-country regime*	0	+++	---	---	+/-
Option 5 – Combination of Options 2 and 3	0	+++	++	++	+++

	Summary of winners and losers			
	EU CSDs	/Issuers	Investors	Supervisory authorities
Option 1	0	0	0	0
Option 2	++	++	++	++
Option 3	++	+/-	+/-	+++
Option 4	++	+/-	+/-	++

Option 5	++	++	++	+++

Legend: +++ = Very positive ++ = Positive + = Slightly positive +/- = Mixed effect **0** = no effect **-** = Slightly negative **--** = Negative **---** = very negative

7. How do the options compare?

The preceding section analyses the policy options for each of the five key drivers considered in this impact assessment and explains the choice of the preferred policy options. A comparison of the different policy options is summarised in the table below.

		Effectiveness				
		Objective 1 Minimise barriers to cross-border settlement	**Objective 2** Ensure adequate powers and information to monitor risks	**Objective 3** Reduce administrative burden and compliance costs	Efficiency *(Cost effectiveness)*	Coherence
Passporting require-ments	**Option 1** Do nothing (baseline)	0	0	0	0	0
	Option 2 Reduce the scope of the passporting requirements	+	-	+	+	+
	Option 3 Clarify uncertainties	-	+	+	+	+
	Option 4 Replace passporting procedure at the host Member State level with a notification	+++	+/-	+++	+++	+++
	Option 5 Combination of Option 3 and Option 4	+++	+	+++	+++	+++
Cooperation between authorities	**Option 1** Do nothing (Baseline)	0	0	0	0	0
	Option 2 Enhance cooperation arrangements	0	0	0	0	0
	Option 3 Establish colleges	++	++	++	++	++
	Option 4 EU supervision	+++	+++	+/-	--	+++
Banking services	**Option 1** Do nothing (Baseline)	0	0	0	0	0
	Option 2a	++	+	+	-	--

	(remove DCI restrictions)					
	Option 2b Banking CSDs to provide services to other CSDs incl. intragroup	++	+	+	++	++
	Option 3 Amend threshold	+++	+	+++	+++	++
	Option 4 Combination of options 2(b) and 3	+++	+	+++	+++	++
Settlement discipline	**Option 1** Do nothing (Baseline)	0	0	0	0	0
	Option 2 Targeted amendments	0	0	+++	+++	++
	Option 3 Two-step approach	0	0	++	++	++
	Option 4 Voluntary buy-in	0	0	-	-	+/-
	Option 5 Two-step approach with targeted amendments	0	0	0	+++	++
Third-country CSDs	**Option 1** Do nothing (baseline)	0	0	0	0	0
	Option 2 Introduction of an end-date to grandfathering clause	0	++	++	++	+++
	Option 3 Introduction notification requirement for third-country CSDs	0	+++	+/-	++	+++
	Option 4 Enhance CSDR third-country regime	0	+++	---	---	+/-
	Option 5 – combination of Options 2 and 3	0	+++	++	++	+++

Legend: +++ = Very positive ++ = Positive + = Slightly positive +/- = Mixed effect **0** = no effect **-** = Slightly negative **--** = Negative **---** = very negative

8. PREFERRED PACKAGE

8.1. Summary of preferred aggregated options

Section 7 analyses and compares the policy options for each of the drivers considered in this impact assessment. The section below explain why each preferred policy options represents the best overall trade-off between effectiveness and costs, hence is the most proportionate and efficient one in the long run.

Passporting requirements: Based on the assessment and comparison of all options, **Option 5 (combination of Option 3 – clarification of uncertainties – and Option 4 – passporting notification) is the preferred option**. The analysis shows that it is better suited to achieve the specific objectives of reducing administrative burden and compliance costs as well as minimising barriers to cross-border settlement than all other options. Concerns of certain national authorities that their powers may as a result be reduced are addressed by the preferred policy option to enhance the cooperation between authorities by requiring the establishment of colleges.

Cooperation between authorities: Based on the assessment and comparison of all options, **Option 3 (mandatory colleges of supervisors) is the preferred option**. It allows to better achieve the specific objective of minimising barriers to cross-border settlement and ensuring adequate powers for authorities to monitor risks than all the other options. In particular, Option 3 is more appropriate and proportionate in attaining the right balance between achieving the aforementioned objectives while reflecting the fact that responsibility remains with the Member States.

Banking services: Based on the assessment and comparison of all options, **Option 2b (allow banking CSDs to offer services to other CSDs) in combination with Option 3 (amend thresholds) are preferred** (together referred to as Option 4). They allow for enhanced cross-border transactions in foreign currencies and more competition, which is in line with CMU. Increased risks to financial stability are limited and could be managed.

Settlement discipline: Based on the assessment and comparison of all options, **a combination of Option 2 (Clarifications to the rules governing settlement discipline) and Option 3 (two-step approach - deferred implementation of mandatory buy-ins) are preferred (represented as Option 5)**. It allows to introduce the necessary clarifications with regards to in-scope transactions or the use of buy-in agents. Option 2 will reduce the complexity (pass-on mechanism) and burden of the regime both for market participants and regulators. Furthermore, Option 3 will provide the necessary incentives, through the use of cash penalties, for necessary improvements in settlement efficiency. At the same time Option 3, allows to avoid the most negative impacts of buy-ins. Indeed, considering the negative impacts on liquidity, pricing and market Option 3 allows time for the regulators to revise and improve the buy-in regime and set the appropriate terms of entry into application of mandatory buy-ins, should cash penalties alone prove insufficient in addressing settlement fails rates in the EU.

Third-country CSDs: Based on the assessment and comparison of all options, **Option 5,** i.e. the combination of Options 2 (end of the grandfathering clause) and 3 (notification for third-country CSDs), is **preferred**. It allows to better achieve the specific objectives of ensuring adequate information for authorities to monitor risks, having a positive impact CSDs, investors and supervisory authorities at national and EU level. As very little information is currently available on third-country CSD's activities in the EEA, any other option would seem either inadequate or premature and disproportionate in terms of budget required compared to the risks currently identified.

8.2. Combined impacts of the package

8.2.1. Overall impact of the package on relevant stakeholders[242]

The overall package of options will have a positive effect, enabling a more proportionate regulation of CSDs and enhancing the competitiveness of the EU settlement market.

CSDs would notably benefit from reduced costs when operating cross-border in the EU, due to a reduction in barriers to cross-border settlement from the setting up of mandatory colleges and the replacement of the passporting procedure at the host Member State level by a simple notification. The introduction of mandatory colleges would also positively impact EU CSDs due to the legal certainty arising from more supervisory convergence and a reduction in the number of interactions by CSDs with various national authorities in the EU. CSDs would benefit from a reinforced level playing field, both within the EU, with the introduction of mandatory colleges that would help ensure consistency in supervisory approaches across the EU, and outside the EU, with the introduction of an end-date of the grandfathering clause for third-country CSDs.

The preferred options regarding the provision of banking services related to settlement in foreign currencies may also create additional opportunities for CSDs that do not hold a banking license. In particular, increasing the threshold could enable some CSDs to develop their services to investors both domestically and cross-border, and thus obtain appropriate economies of scale to cover authorisation costs to provide banking services themselves at a later date. The proposed changes to the settlement discipline regime would ensure a more proportionate approach to the treatment of settlement fails, thus avoiding certain unnecessary implementation costs. Finally, competition between CSDs could also drive more innovation by CSDs and hence compounding benefits in terms of settlement efficiency and international competitiveness.

Under the preferred options, **investors and issuers** would benefit from an increased competition between CSDs due to the replacement of the passporting procedure at the host Member State level with a simple notification and the establishment of mandatory colleges. In the same vein, under the preferred options regarding the provision of banking services related to settlement in foreign currencies by non-banking CSDs, issuers and investors would have more choice in terms of financing arrangements and would benefit from the increased competition, a greater choice in issuance, risk diversification and currency diversification in their cross-border investments. The enhanced supervision of EU CSDs through the establishment of colleges and of third-country CSDs through the end-date for the grandfathering clause and the notification requirements could have a positive impact on the protection of issuers and investors, by ensuring that ESMA is aware of any potential risks.

Finally, the proposed changes to the settlement discipline regime would ensure a more proportionate approach to the treatment of settlement fails for investors, thus avoiding certain unnecessary implementation costs, while ensuring that levels of settlement efficiency continue to improve in the EU.

Under the preferred policy options, **ESMA** may incur limited additional costs but would benefit from a strengthened supervisory environment due to establishment of colleges

[242] See Annex 4 for more details on the specific impacts of the preferred package on the relevant stakeholders.

and the increased information it will obtain for the activities of third-country CSDs. In terms of costs, ESMA would mainly be impacted by the participation to mandatory colleges and the management of the process for the notification by third-country CSDs of their EU activities, as well as the need to develop and revise regulatory technical standards. The latter would however be a small one-off cost that could potentially be covered by a notification fee to be paid by each third-country CSD. The replacement of the passporting procedure by a notification would nevertheless alleviate ESMA's costs as the passporting requirements would be simpler and clearer. Further, a clear determination of in-scope transactions would also lessen the administrative burden on ESMA related to replying to Q&As. ESMA would also benefit from some of the preferred policy options which would strengthen the supervisory environment, in particular the notification process for third-country CSDs.

Finally, the impact of the preferred policy options on **national authorities** would be limited but generally positive. In particular, they will alleviate the costs and time spent on passporting if the possibility for the host Member State authority to refuse the passporting request is removed.

8.2.2. Impact on small and medium sized enterprises

The proposed options in the Impact Assessment are not expected to have any direct material impact on SMEs. However, the postponement of the mandatory buy-in regime should alleviate the most negative impacts of mandatory buy-ins related to liquidity.[243] This should indirectly positively impact SMEs, whose securities are less liquid. In addition, SMEs could benefit indirectly from improvements which could lead to a more efficient and sound settlement system, notably through removing inefficiencies in the system and promoting competitiveness (e.g. through measures to facilitate the cross-border provision of services and reduce disproportionate costs). In addition, easier cross-border settlement could lower issuance costs and cost of capital for European issuers, in particular innovative start-ups and SMEs. Together these could help attract SMEs to capital markets and contribute to a deepening of CMU.

8.2.3. Social impact

The proposed options in the Impact Assessment are not expected to have any material social impact.

8.2.4. Environmental impact

The initiative in question has no direct and/or identifiable impacts leading to significant harm or affecting the consistency with the climate-neutrality objectives and the obligations arising out of the European Climate Law.

8.2.5. Impact on financial stability

The overall impact of the package of preferred options on financial stability is neutral or positive. On the one hand, the adjusted requirements for the provision of banking-type ancillary services to facilitate settlement in foreign currencies mean that financial stability risks could theoretically increase as credit, liquidity but also concentration risks rise. However this could be mitigated by: limiting the increase of the threshold;

[243] CSDR aims at limiting the impact of the buy-in regime on SMEs, by introducing a specific extension period of 15 business days before the triggering of the buy-in (instead of 4 to 7 business days – see Annex 9 for more details on the buy-in process). Such longer extension period may however prove insufficient for SMEs with the least liquidity and, once the delay is reached, the buy-in procedure will apply like for other financial instruments.

increasing supervisory monitoring by the relevant authorities; and setting accompanying risk requirements, such as minimum risk mitigation standards (e.g. creditworthiness, concentration limits). On the other hand, other preferred options could strengthen financial stability. This is notably the case of the establishment of mandatory colleges (which would strengthen the supervision of CSDs across the EU), the proposed targeted amendments to the settlement discipline regime, including the two-step approach and targeted amendments (which, while encouraging improved settlement, could allow some of the potentially most negative impact of mandatory buy-ins related to liquidity, bid-ask spreads or market stability to be mitigated) and the notification procedure for third-country CSDs (which would allow national authorities and ESMA to have a better understanding of the activities carried out by third-country CSDs in the EU, and consequently of the potential risk they may pose to financial stability in the EU).

8.2.6. Impact on the EU budget

The above policy options should not in principle have any implications for the EU budget. Possible additional tasks arising for ESMA, such as the development of additional technical standards and the participation to mandatory colleges should be manageable within their current resources, in particular given the reduced number of Q&As and/or need for clarifications that modifications, e.g. to the settlement discipline regime, that should be needed. The management of the process for the notification by third-country CSDs of their activities within the EU, would be a one-off cost. However, in principle, it could potentially be covered by a notification fee to be paid by each third-country CSD.

8.3. REFIT (simplification and improved efficiency)

The need to eliminate disproportionate costs and burdens to small companies, and to simplify rules without putting financial stability at risk is the reason the CSDR review was included in the 2021 Commission's Regulatory Fitness and Performance programme (REFIT). As part of REFIT, the Commission assessed the extent to which policy requirements in CSDR have met their objectives in an efficient and effective way, while at the same time being coherent, relevant and providing EU added-value.

The evaluation indicates that, even though the impact on settlement efficiency and financial stability is not yet fully measurable, CSDR may impose in some targeted areas disproportionate costs and burdens and that certain requirements may be simplified to achieve the objective of financial stability more efficiently. These areas include: (1) cross-border provision of services in the EU; (2) provision of banking-type ancillary services; and (3) settlement discipline. This impact assessment therefore considers the costs and benefits of areas where targeted action could ensure fulfilment of the CSDR's objectives in a more proportionate, efficient and effective manner. This impact assessment provides evidence that a reduction of costs and burdens can be achieved hand-in-hand with a simplification of CSDR, without compromising financial stability. Such evidence includes input received from market participants and various authorities.

Table	***REFIT Cost Savings – Preferred Option(s)***	
Description	***Amount***	***Comments***
Replacing the passporting procedure at the host Member State level with a	Potential savings of ca. EUR 10 million in the first year; thereafter ca. EUR 4 million per year.	Estimate is based on Commission calculations on the basis of confidential data. It is assumed that the notification process would enable 10 other CSDs to passport in 26 Member States. This could help to save ca. EUR 5 850 000 for CSDs (one-off benefit) as well as ca. EUR 390 000 for CSDs per year (recurring cost saving). It could also help to save ca. EUR 590 000 for 27 national authorities (one-off

notification		benefit).
Establishment of mandatory supervisory colleges	Benefits of streamlined procedures, not quantifiable. ESMA will incur some costs. These are likely to be offset by savings from greater legal clarity. Overall, net benefits are expected.	Colleges will: ensure supervisory convergence, provide greater legal certainty for CSDs and will help reduce the level of interactions of CSDs with various national authorities across the EU. While these cost savings cannot be quantified, they are expected to be significant.
Amendment of rules for banking-type ancillary services	Small to moderate net benefits.	CSDs as well as issuers and investors benefit from better opportunities to offer foreign currency settlement. This is a recurrent opportunity cost saving estimated by the Commission based on qualitative input. Potential benefits of up to EUR 80 billion in increased settlement activity, in particular in CSDs not currently providing these services. A large amount may also however be offset as CSDs currently providing banking services may lose business to new entrants.
Phased-in approach to settlement discipline and clarification of rules	Up to 375 million annually of saved connection costs. Deferred introduction of mandatory buy-in will prevent some trading volumes disappearing or migrating outside the EU (Estimated at up to 4% - 5% of trade volume, equal to EUR 7 trillion annually).	The proposed two-step approach would result in deferred cost related to the setting up of a buy-in agent offering by one entity. However, this is offset by the fact that the average cost per market participant to set up a connection to a buy-in agent would be around EUR 1 million, amounting to EUR 1.5 billion for all in-scope market participants in the EU for four years (375 million annually). Depending on the potential targeted changes to be made to the buy-in regime, such costs savings could either be temporary (i.e. until the buy-in regime enters into force) or permanent (e.g. if the changes allow for a simplified approach regarding the requirements related to buy-in agents). Although not quantifiable, cost savings are also expected for both market participants and CSDs from the proposed clarifications of the buy-in and cash penalties rules.
Notification of third-country CSDs and introducing an end-date to the grandfathering clause	0	Based on Commission estimates following the submission of confidential data, assuming that 5 third-country CSDs would notified, the costs would be estimated around ca. EUR 13 000 for ESMA. This would be one-off cost that could potentially be covered by a notification fee to be paid by each third-country CSD. We currently do not know how many third-country CSDs are using the grandfathering clause and would apply for recognition to ESMA. It has been assumed that ESMA can carry out its other permanent tasks, such as in relation to non-EU CSD recognition with its existing staff.

9. HOW WILL ACTUAL IMPACTS BE MONITORED AND EVALUATED?

The envisaged options aim at rendering the application of CSDR more effective and efficient. To this end, a number of targeted adjustments to CSDR are considered. The proposed legislative amendment to CSDR should include a provision stating that an evaluation of CSDR in its entirety should be carried out, with a particular focus on its effectiveness and efficiency in meeting its original objectives (i.e. improve the efficiency and safety of EU settlement markets). The evaluation should thus consider all aspects of CSDR, but in particular the elements shown in the table below to monitor and evaluate progress towards meeting the specific objectives.

Specific objective to	Monitoring indicators	When will monitoring	By whom	Source of informati

measure		start		on
Ensure adequate powers and information to monitor risks	Number of 3rd country CSDs that have applied for recognition. Number of colleges established by EU CSDs.	From date of application of the proposed amendments to CSDR.	ESMA	ESMA
Reduce administrative burden and compliance costs	EU settlement efficiency rates. Average (no. of days) duration of settlement fails. Number of CSDs providing cross-border services. Number of countries in which CSDs provide cross-border services. Number of CSDs able to access banking services. Number of CSDs providing foreign currency settlement. Number of CSDs able to use the exception under the threshold.	1 year after date of application of the proposed amendments to CSDR.	ESMA, ESCB, CSDs	ESMA
Minimise barriers to cross-border settlement	Number of CSDs providing cross-border services. Number of countries in which CSDs provide cross-border services. Number of CSDs able to access banking services. Growth of foreign currency settlement. Number of CSDs providing foreign currency settlement. Number of CSDs able to use the exception under the threshold.	1 year after date of application of the proposed amendments to CSDR.	ESMA, ESCB, CSDs	ESMA

In principle, this evaluation should take place at least 5 years after the application of these amendments. The evaluation should seek to collect input from all relevant stakeholders, but in particular CSDs, banks and custodians, investment funds, investors and issuers. Input would also be required from ESMA as well as national authorities and central banks. Statistical data for the analysis should be sought primarily from ESMA.

ANNEX 1: PROCEDURAL INFORMATION

Lead DG, Decide Planning/CWP references

- Lead Directorate-General: Directorate-General for Financial Stability, Financial Services and Capital Markets Union.
- Decide Planning Reference: PLAN/2020/8721
- CWP references: The initiative is included in the Commission Work Programme 2020[244] as a REFIT item.[245]

Organisation and timing

- Organisation and timing of Inter Service Steering Group's meetings: the Inter Service Steering Group included representatives of the Directorates General Climate Action (CLIMA), Competition (COMP), Economic and Financial Affairs (ECFIN), Internal Market, Industry, Entrepreneurship and SMEs (GROW), Justice and Consumers (JUST), Taxation and Customs Union (TAXUD), Trade (TRADE), the Legal Service (LS) and the Secretariat General (SG).
    - 1st Meeting on 19 February 2021;
    - 2nd meeting on 25 June 2021;
    - 3rd meeting on 9 September 2021;
    - Written consultation (17- 23 September 2021).

Consultation of the RSB

- The draft Impact Assessment was submitted to the Regulatory Scrutiny Board on 29 September 2021, for consideration at a meeting on 27 October 2021. The Regulatory Scrutiny Board issued a positive opinion on 29 October 2021 (ARES(2021) 6677103 - 29/10/2021)

Evidence, sources and quality

Evidence used in the impact assessment came from a variety of sources, including:

- Replies by stakeholders to a targeted consultation which ran from 8 December 2020 and 2 February 2021 to obtain feedback on the implementation of CSDR[246]:
- Reports from the European Securities and Markets Authority including:
    - Report on internalised settlement[247];
    - Report on the cross-border provision of services by CSDs[248];
    - Report on the provision of banking-type ancillary services under CSDR[249];
    - Report on the use of FinTech by CSDs[250].

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[244] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Commission Work Programme 2021 'A Union of vitality in a world of fragility', Annex I, COM(2020) 690 final.

[245] REFIT is the Commission's Regulatory Fitness and Performance programme.

[246] Summary Report of the Commission CSDR targeted consultation (see note 92).

[247] ESMA Report on internalised settlement (see note 86).

[248] ESMA Report on cross-border services (see note 50).

[249] ESMA Report 'Provision of banking-type ancillary services under CSDR' (see note 88).

[250] ESMA Report 'Use of Fintech by CSDs' (see note 89).

- Report from the Commission to the European Parliament and Council under Article 75 of Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (COM(2021) 348 final).[251]
- Discussions with experts from Member States' authorities: Meetings held on 22 September 2020, 15 July 2021.[252]
- Discussions with MEPs from the Economic and Monetary Affairs Committee: 6 September 2021.
- Statistics and reports published by the European Central Bank and the Bank of International Settlements (BIS). In the case of the European Central Bank the Statistical Data Warehouse[253] was used and in particular the data compiled in the "Securities Trading, Clearing and Settlement Statistics"[254]. For international comparison the data provided by the Bank for International Settlement, Committee on Payments and Market Infrastructures[255] was used. The Committee periodically publishes reference works on payment, clearing and settlement systems in the member countries.

ANNEX 2: STAKEHOLDER CONSULTATION

This annex outlines the feedback received from stakeholders via the targeted consultation on the CSDR review (section 1), and in the context of building a Capital Markets Union (section 2). It provides information on the reports provided by ESMA (section 3) as well as an overview of an exchange of views on the CSDR review with representatives of Member States, of EU bodies and authorities, during the meeting of the Derivatives and Market Infrastructures Member States Working Group, which took place in Brussels on 22 September 2020 and 15 July 2021 (section 4).

1. TARGETED CONSULTATION

First, a **targeted public consultation**[256] on the CSDR review was conducted between 8 December 2020 and 2 February 2021. The Commission sought feedback in areas where targeted action may be necessary to ensure the fulfilment of the objectives of the CSDR in a more proportionate, efficient and effective manner, notably:

- CSD authorisation & review and evaluation processes;
- cross-border provision of services in the EU;

[251] CSDR Review report (see note 9).

[252] Summaries are available at: https://ec.europa.eu/transparency/expert-groups-register/screen/meetings/consult?lang=en&meetingId=22398&fromExpertGroups=false ; https://ec.europa.eu/transparency/expert-groups-register/screen/meetings/consult?lang=en&meetingId=28987&fromExpertGroups=false.

[253] European Central Bank Statistical Data Warehouse, Payment Statistics: https://sdw.ecb.europa.eu/browse.do?node=9691104.

[254] See the latest edition "Securities trading, clearing and settlement statistics – June 21", European Central Bank, available at: https://sdw.ecb.europa.eu/reports.do?node=1000004055.

[255] For a compilation of data and publication on settlement see Bank for International Settlement, Committee on Payments and Market Infrastructures: https://www.bis.org/cpmi/paysysinfo.htm.

[256] The targeted consultation questionnaire is available at: https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en

- internalised settlement;
- CSDR and technological innovation;
- authorisation to provide banking-type ancillary services;
- scope of requirements applying to the settlement of financial instruments;
- settlement discipline.

The Commission received 91 responses to the targeted consultation. The feedback statement summarising the responses received was published on the Commission website[257]. The majority of responses came from firms and industry associations, i.e. 43 companies/business organisations and 33 business associations. In addition, responses were received from 10 public authorities, one NGO and four entities categorised as "Other". Among the companies and business associations responding, most indicated the following as their main field of activity: banking (30 respondents), operation of financial market infrastructure (23 respondents) or investment management (13 respondents). No private individuals responded to this targeted consultation. Responses were received from 18 Member States, with the largest number coming from Germany (12), Belgium (8), France (8) and the Netherlands (7). In addition, a number of responses came from outside the EU, mainly the United Kingdom (17) and the United States (8).

The key messages from the consultation were the following:

- According to a vast majority of respondents, the rules on the cross-border provision of services in the EU need to be revised, in particular to clarify and simplify the passporting rules as well as to enhance the cooperation between national competent authorities (NCAs).
- CSDs argued that the rules on the authorisation to provide banking-type ancillary services hinder settlement in foreign currencies and restrict access to liquidity for CSDs not authorised to provide banking-type ancillary services.
- The settlement discipline regime was the topic for which the Commission received the most contributions. All stakeholders agreed that clarity on the way forward is needed as soon as possible.
- The framework for third-country CSDs raised questions amongst all categories of stakeholders, in particular on the need to have more information on third-country CSDs providing services in relation to financial instruments constituted under the law of a Member State.
- Respondents supported the simplification of certain requirements regarding CSDs' authorisation, annual review and evaluation, as well as review of the grandfathering clauses.
- A majority of respondents stated that immediate action is not required on two topics: (a) technological innovation, because any changes to CSDR to realise the full potential of fintech should be postponed until the Pilot Regime Regulation is agreed upon by the colegislators and implemented; and (b) internalised settlement, as the obligation has only been in force for a limited period.

  In addition to the public consultation, DG FISMA also received confidential information from a number of firms.

[257] Summary Report of the Commission CSDR targeted consultation (see note 92).

2. Capital Markets Union

Building on its goal to finalise the creation of capital markets union (CMU), the Commission launched a call for expression of interest to join a **High-Level Forum (HLF) on capital markets union** on 10 October 2019.

On 10 June 2020 the **HLF published its final report**[258] and recommended, amongst others, that the Commission conducts a targeted review of CSDR to strengthen the CSD passport and improve supervisory convergence among national competent authorities. It also invited national central banks to facilitate the servicing of domestic issuance in non-domestic central bank money. A **call for feedback** on this final report has provided the Commission with views from a wider range of stakeholders.

The **2020 CMU Action Plan**[259] announced the Commission's intention to come forward with a **legislative proposal to amend CSDR** to improve its efficiency and effectiveness (CSDR REFIT) and contribute to the development of a more efficient post-trading landscape in the EU. In particular, **Action 13 (developing cross-border services) states that** "*to improve the cross-border provision of settlement services in the EU without negatively impacting financial stability, the Commission will review the rules covering a wide range of topics, including: (i) the cross-border provision of services by CSDs on the basis of a CSD passport and (ii) the procedures and conditions under which CSDs have been authorised to designate credit institutions or themselves to provide banking-type ancillary services*".

3. ESMA

Under Article 74 of CSDR, **ESMA is required to submit a number of reports to the Commission** on the implementation of the Regulation annually. **Four reports published in 2020 and 2021 were submitted to the Commission in the context of the CSDR review**. In November 2020, ESMA submitted two reports on internalised settlement[260] and the cross-border provision of services by CSDs and the handling of applications to provide notary and central maintenance services cross-border[261]. In July and August 2021, ESMA submitted two additional reports on the provision of banking-type ancillary services under CSDR[262] and the use of fintech by CSDs[263].

On **20 May 2021**, ESMA also sent **a letter to the Commission**[264] suggesting changes in three areas: in relation to T2S, the third-country recognition regime, and the frequency of ESMA reports to the European Commission on CSDR implementation. ESMA sent

[258] Final report of the High Level Forum on the Capital Markets Union (see note 70).(europa.eu).:

[259] Commission Communication 'A Capital Markets Union for people and businesses – New Action Plan' (see note 10), Action 13.

[260] https://www.esma.europa.eu/sites/default/files/library/esma70-156-3729_csdr_report_to_ec_-_internalised_settlement.pdf

[261] https://www.esma.europa.eu/sites/default/files/library/esma70-156-3569_csdr_report_to_ec_-_csd_cross-border_services.pdf

[262] esma70-156-4582_report_to_the_ec_-_csdr_banking_services.pdf (europa.eu)

[263] Report to the European Commission: use of Fintech by CSDs, ESMA, 2 August 2021: https://www.esma.europa.eu/sites/default/files/library/esma70-156-3569_csdr_report_to_ec_-_csd_cross-border_services.pdf

[264] https://www.esma.europa.eu/sites/default/files/library/esma70-156-4519_letter_to_ec_-_csdr_review.pdf

another letter on 23 September 2021, supporting a delay in the application of the buy-in regime.[265]

4. Meeting of the Derivatives and Market Infrastructures Member States Working Group

The Commission conducted several meetings with Member States, stakeholders, and MEPs. In particular, in September 2020, the Commission held a Member States' Expert Group meeting. The European Parliament Economic and Monetary Affairs Committee secretariat, the ECB and ESMA were also invited. A subsequent meeting was held in July 2021 to consider a wide range of policy options and their potential impacts. A summary of the discussions is available online for both meetings[266]. In addition, a meeting was held on 6 September 2021 with MEPs to present the CSDR report[267] and the next steps.

[265] ESMA letter to the European Commission, 'ESMA's views on the way forward on settlement discipline in the context of the CSDR review', 23 September 2021. Available at: https://www.esma.europa.eu/file/120971/download?token=IjhiamXS.

[266] Link to the minutes of the meetings to be added once they are published.

[267] Report from the Commission to the European Parliament and the Council under Article 75 of Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, COM(2021) 348 final, 1 July 2021: https://ec.europa.eu/finance/docs/policy/210701-csdr-report_en.pdf

Annex 3: Who is affected and how?

Practical implications of the initiative

1. Implications for CSDs

Most options retained have a positive effect ensuring more proportionate regulation of CSDs and enhancing the competitiveness of the EU settlement market.

First, CSDs would benefit from reduced costs when operating in the EU, notably due to a reduction of barriers to cross-border settlement stemming from the setting up of mandatory colleges and the replacement of the current passporting procedure at the Member State level by a simple notification.

In particular, the passporting requirements related to national laws and the role of national authorities are the ones that raised most issues. Removing such requirements would alleviate, clarify and accelerate the passporting process. This benefit would be ongoing. Should a CSD wish to passport in 26 Member States to be able to provide services throughout the EU, it is estimated that it would cost on average at least EUR 780 000 (see section 2.3.1). Should the simplified passporting process reduce by 75% the costs of passporting, this CSD would incur a one-off saving, on average, EUR 585 000. Currently 15 CSDs are providing services cross border in at least one Member State. If the simplified passporting process allows at least 10 other CSDs to passport in 26 Member States this would help to save on average EUR 5 850 000 for CSDs. This would be a one-off benefit for CSDs.[268] Ongoing costs of monitoring compliance with the passport would also be significantly reduced. Should a CSD passport in 26 Member States to provide services throughout the EU, it is estimated that it would cost on average at least EUR 52 000 per year (see section 2.3.1). Should the simplified passporting process reduce by 75% the costs of passporting, this CSD would be saving, on average, EUR 39 000 per year. Currently 15 CSDs are providing services cross border in at least one Member State. If the simplified passporting process entails at least 10 other CSDs to passport in 26 Member States this would help to save ca. EUR 390 000 for CSDs per year. This would be ongoing benefit for CSDs.

The introduction of mandatory colleges would also benefit to EU CSDs due to the legal certainty related to the enhancement of supervisory convergence and reduction of the level of interactions of CSDs with various national competent authorities across the EU.

Second, CSDs would benefit from a reinforced level playing field, both within the EU, with the introduction of mandatory colleges that would help ensuring consistency of the supervisory approaches across Member States, and outside the EU, with the end date of the grandfathering clause for third-country CSDs. The implementation of a notification requirement by third-country CSDs regarding the activities they carry out within the EU and/or with EU participants would also indirectly benefit to EU CSDs, as it would help identify which third-country CSDs provide services and in which volumes, thus increasing transparency in the market for EU CSDs.

Third, the preferred options regarding the provision of banking services related to settlement in foreign currencies may create additional opportunities for CSDs that do not

[268] Commission calculations based on confidential information provided to DG FISMA services.

hold a banking license and thus increase competition in this domain. The option consisting in allowing CSDs already authorised to provide banking services (or "banking CSDs") to offer such services to CSDs that do not have such authorisation ("non-banking CSDs") could immediately start since it would not require any further authorisation and the risk management arrangement are already in place at the level of the banking CSDs. On the downside, it could favour groups that already include a banking CSDs and, from a risk perspective, concentrate the risks within such groups.

Increasing the threshold could enable some CSDs to develop their services to investors both domestically and cross-border and thus obtain appropriate economies of scale to cover authorisation costs to provide banking services themselves. The combination of these would further amplify the possible benefits.

It is estimated that[269] EUR 16 billion additional settlement in foreign currencies could be expected on an annual basis[270]. If extrapolated to the total number of EEA non-banking CSDs, this could mean an additional annual possible offering of at least EUR 80 billion of settlement in foreign currencies. This does not take into account whether if this additional settlement would affect existing settlement in foreign currencies undertaken by CSDs already authorised to provide ancillary banking services. The additional offering of settlement in foreign currencies would tap in the identified demand, mostly in the area of bonds where a lack of offering holds back multi-currency bond issuance. Increased competition between CSDs could also drive more innovation by CSDs and hence settlement efficiencies.

An unlikely negative effect could be the possible increased probability of contagion effects on settlements through defaults of settlement agents in foreign currencies (proportionate to the increased thresholds).[271] This could however be offset by increased supervision regarding the relevant credit institutions providing the services to CSDs. One-off costs (authorisations or setting up the operational capacity) could be covered by longer term providing of the service.

Finally, the proposed changes to the settlement discipline regime would ensure a more proportionate approach to the treatment of settlement fails. The target amendments contemplated for cash penalties and mandatory buy-in would bring the needed clarity to CSDs in order to implement these requirements in the most efficient manner. CSDs would be affected directly by the suspension of the buy-in framework, and there would be sunk (or at least delayed) costs to a greater or lesser degree depending on the CSD in question.[272]

2. IMPLICATIONS FOR ISSUERS

Under the preferred options, issuers would benefit from increased competition between CSDs. The replacement of the passporting procedure at the level of the host Member State with a simple notification would increase cross-border activities. In addition, an improved framework for the cross-border provision of services through the establishment

[269] European Commission consultation, ECB consultation (confidential) and ESMA Report 'Provision of banking-type ancillary services under CSDR' (see note 88).

[270] Current total absolute value of settlement of the CSDs and applied the growth percentages mentioned by the CSDs themselves. This gives an anticipated total of settlement in foreign currencies (settlement + corporate actions). We then subtracted from these figures the current absolute values in foreign currencies, which gives the anticipated total net gain from the proposed CSDR changes.

[271] Confidential information provided to DG FISMA services.

[272272] Supported by confidential information provided to DG FISMA services.

of mandatory colleges could lead to an increased supervisory convergence, thus removing some barriers to the competition between CSDs. Together, the proposed changes to CSDR could lead to more competition between CSDs and a wider choice for issuers of listing venues and access to a deeper capital market.

In the same vein, under the preferred options regarding the provision of banking services related to settlement in foreign currencies by non-banking CSDs, issuers would have more choice in terms of financing arrangements and would benefit from increased competition and a greater choice in issuance.

The enhanced supervision of EU CSDs through the establishment of colleges and of third-country CSDs through the end-date for the grandfathering clause and the notification requirements could have a positive impact on the protection of issuers and investors. In particular, the end of the grandfathering clause for third-country CSDs could positively affect issuers on an ongoing basis as third-country CSDs would have to operate under a regime equivalent to CSDR, and therefore according to the same standards in terms of protection of issuers. The notification requirement for third-country CSDs would also have a positive impact on issuers as it would increase transparency in the market, which would help identifying any potential risks, in particular on financial stability.

With regard to the end of the grandfathering clause for third-country CSDs it should however be noted that, as very little information is available on how many third-country CSDs operate in the EU, this option, when it enters into place, may reduce the number of services offered by third-country CSDs in the EU.

Lastly, issuers would benefit from specific clarifications with regards to transactions that are in-scope of the settlement discipline regime. For example, according to some stakeholders, exempting ETP (exchange-traded products) primary market transactions from mandatory buy-in could potentially help avoid a circular scenario whereby the ETP provider creates ETP units just to receive these same units back through the buy-in process to subsequently cancelling them[273].

3. IMPLICATIONS FOR INVESTORS

The main benefits of the chosen options for investors would stem from increased competition between CSDs as well as the introduction of a two-step approach and clarifications to the settlement discipline regime. Competition between CSDs would be enhanced by the replacement of the passporting procedure at the level of the host Member State with a simple notification or through greater supervisory convergence thanks to the establishment of mandatory colleges which would lead to increased CSD cross-border activities. Together, such changes could lead to more integrated capital markets, more efficient settlement, including cross-border settlement, benefitting investors.

Similarly greater access to settlement in foreign currencies by non-banking CSDs would give investors more choice in terms of instruments and hence greater risk and currency diversification in their cross-border investments.

The enhanced supervision of EU CSDs through the establishment of colleges and of third-country CSDs through the end-date for the grandfathering clause and the

[273] See EFAMA public consultation reply, Q.31.2 & Q.34.1

notification requirements could have a positive impact on the protection of investors, by giving providing the market with greater transparency, predictability and regulatory stability.

With regard to the end of the grandfathering clause for third-country CSDs it should however be noted that, as very little information is available on how many third-country CSDs operate in the EU, this option, when it enters into place, may reduce the number of services offered by third-country CSDs in the EU.

Finally, the proposed changes to the settlement discipline regime would ensure a more proportionate approach to the treatment of settlement fails, while ensuring that levels of settlement efficiency continue to improve in the EU, benefitting investors.

The targeted amendments contemplated for cash penalties and mandatory buy-in would bring necessary clarifications to investors in order to implement these requirements in the most efficient manner. In particular, amendments to the pass-on mechanism would allow solving all settlement fails along the same chain by one buy-in in the original settlement fail which provoked the other fails. According to one estimate the introduction of a pass-on mechanism would reduce costs by 37.5%[274]. This would be combined with measures to address the rigidness in timing of when a buy-in is initiated and the asymmetry in price differentials[275]. These technical clarifications would reduce the complexity and the burden of managing a buy-in process, hence costs for investors. In addition, certain transactions would no longer be subject to the settlement discipline regime further to the proposed change of scope, which would permanently reduce the compliance burden on market participants by removing certain transactions.

Regarding the two-step approach for mandatory buy-in, the major negative impacts in terms of liquidity and market stability caused by mandatory buy-ins would be, at least temporarily, avoided. Such approach would also avoid a duplicative repapering work for participants that could arise due to changes to the regime under the targeted amendments previously proposed (which would have otherwise been implemented after the entry into force of the buy-in regime, thus triggering the need for participants to do some repapering in order to take into account such changes).

It should be noted that the proposed two-step approach would result in sunk cost related to the setting up of a buy-in agent offering by one entity (the only one buy-in agent service provider that has emerged so far).[276] However, this is offset by the fact that to comply with the buy-in requirements, with IT, HR and consulting costs, it is estimated that the average cost per market participant to set up a connection to a buy-in agent would be around EUR 1 million, amounting to EUR 1.5 billion for all in-scope EU market participants[277]. Depending on the potential targeted changes to be made to the buy-in regime, such costs savings could either be temporary (i.e. until the buy-in regime enters into force) or permanent (e.g. if the changes allow for a simplified approach regarding the requirements related to buy-in agents).

4. IMPLICATIONS FOR ESMA

Under the preferred policy options, ESMA may incur limited additional costs but would benefit from a strengthened supervisory environment.

[274] For explanation and calculation of costs savings see J.P. Morgan public consultation reply, Q. 34.1
[275] ICMA, ISLA, AFME public consultation reply.
[276] This is supported by confidential information provided to DG FISMA services.
[277] This is supported by confidential information provided to DG FISMA services.

In terms of costs, ESMA would mainly be impacted by the establishment of mandatory colleges. Indeed, it is estimated that such additional costs may range from about EUR 130 000 to EUR 260 000 per annum depending on the number of CSDs for which colleges could be established and their powers.[278] However, ESMA would be able to benefit from the experience it has already acquired in the field of colleges under EMIR, and therefore very limited, if any, one-off operational costs are envisaged.

Other costs may also arise from the management by ESMA of the process for the notification by third-country CSDs of their activities within the EU. Based on Commission estimates following the submission of confidential data[279], ESMA estimated costs for one third-country CSD notification would amount to ca. EUR 2 600 per notification. Assuming that 5 third-country CSDs would notified, the costs would be estimated around ca. EUR 13 000 for ESMA. This would be one-off cost that could potentially be covered by a notification fee to be paid by each third-country CSD.

In addition, as ESMA grants recognition for third-country CSDs, it might potentially also increase ESMA costs if third-country CSDs which are currently using the grandfathering clause would decide to apply for recognition in order to continue their activities in the EEA. It is not currently known how many third-country CSDs are using the grandfathering clause and would apply for recognition. However, it can be assumed that these costs have been anticipated since CSDR entered into application in 2014.

Finally, ESMA may incur costs in the context of the development of new RTS and ITS in the context of the implementation of the proposed options regarding the provisions of ancillary banking services and the settlement discipline regime.

On the other hand, the simplification of the passporting procedure would alleviate their costs as the passporting requirements would be simpler and clearer. Further, a clear determination of in-scope transactions would also lessen the administrative burden on ESMA related to replying to Q&A's.

Beyond the potential limited costs, ESMA would benefit from some of the preferred policy options which would strengthen the supervisory environment. In particular, the notification process for third-country CSDs would directly positively affect ESMA as it would give the European authority more information and help it to identify and monitor risks. Further, amendments to the pass-on mechanism would be beneficial to ESMA as fewer buy-ins would contribute to market stability. Finally, a clear determination of in-scope transactions would also lessen the administrative burden on ESMA related to replying to Q&A's.

5. Implications for NCAs

The impact of the preferred policy options on NCAs would be limited but generally positive.

Additional costs may be incurred by NCAs due to the need to monitor more closely the ancillary banking activities carried out under the new proposed framework (i.e. higher thresholds and possibility for banking CSDs to provide banking services to non-banking CSDs), and their participations to mandatory colleges (or their organisation, as the case may be).

[278] Commission estimates based on confidential data provided to DG FISMA services.
[279] Based on confidential information provided to DG FISMA services.

Nonetheless, at the same time, their ongoing costs will be reduced due to the streamlined cooperation of authorities and their increased access to information and powers to monitor risks compared to today.

Further, NCAs will alleviate the costs and time spent on passporting if the passporting procedure is simplified. Should a CSD wish to passport in 26 Member States to be able to provide services throughout the EU, it is estimated that it would cost to national authorities altogether at least EUR 79 000 (see section 2.3.5). Should the simplified passporting process reduce by 75% the costs of passporting, the 26 national authorities would be saving all together, on average, ca. EUR 59 000. Currently, 15 CSDs are providing services cross border in at least one Member State. If the simplified passporting process enables at least 10 other CSDs to passport in 26 Member States this would help to save on average EUR 590 000 for 27 national authorities.

Finally, the notification requirement for third-country CSDs would indirectly impact NCAs as they would get information on third-country CSDs activities through ESMA, helping them to identify and monitor risks.

6. IMPACT ON THIRD COUNTRIES

The main impact on third countries would come from the new requirement for third-country CSDs to notify the activities they carry out in the EU and the end of the grandfathering clause for third-country CSDs. In practice however, such impact should be limited, first because the triggering of the recognition requirement further to the end of the grandfathering clause should have been anticipated by the relevant third-country CSDs (the purpose of the grandfathering clause never was to allow third-country CSDs to keep providing services for an indefinite period of time without complying with CSDR provisions), second because the new notification requirement would be a one-off exercise.

The proposed options do not create any new kind of interactions between EU or Member State authorities with third-country authorities.

Summary of costs and benefits

I. Overview of Benefits (total for all provisions) – Preferred Option		
Description	***Amount***	***Comments***
	Direct benefits	
Simplified passporting process and easier provision of cross-border services by CSDs.		Clarified and simplified passporting process, lowering administrative costs for both CSDs and NCAs.
	One-off reduction of administrative costs for CSDs: estimated at ca. EUR 5 850 000 for CSDs.	It is estimated that this can bring about one-off savings of, on average, EUR 585 000 per CSD. The total figure assumes that at least 10 other CSDs passport in 26 Member States.
	Ongoing reduction of compliance costs for CSDs: estimated at ca. EUR 390 000 per year for CSDs.	Savings of, on average, EUR 39 000 per year per CSD. It is estimated that the simplified passporting process would reduce by 75% the costs of passporting. The total figure assumes that 10 CSDs would benefit from the new regime for passporting in 26 Member States.
	One-off reduction of administrative costs for NCAs: estimated at ca. EUR 590 000 for all NCAs.	Total saving of, on average, ca. EUR 59 000 per NCA. Assumptions: the simplified passporting process would reduce by 75% the costs of passporting The total figure also assumes that 26 NCAs benefit from these savings for 10 CSDs passporting into their respective Member States.
Direct increase of cross-border competition between CSDs, benefiting to investors and issuers.	No estimate available.	The replacement of the passporting procedure at the host Member State level with a notification reduces the costs of cross-border entry and thereby facilitates competition. In addition, an improved framework for the cross-border provision of services through the establishment of mandatory colleges could lead to increased supervisory convergence, thus removing additional barriers to cross-border competition. This will benefit both investors and issuers and will increase market efficiency.

Enhanced supervisory convergence.	No estimate available.	The introduction of mandatory colleges would benefit EU CSDs operating cross-border due to the legal certainty related to the enhancement of supervisory convergence and reduction of the level of interactions of CSDs with various national competent authorities across the EU. This would also enhance supervision of CSDs operating cross-border preventing spill-over effects and allow for better management of systemic risk.
Reinforced level playing field for CSDs, both within the EU and outside the EU.	No estimate available.	Within the EU: mandatory colleges would help ensuring consistency of supervision across Member States, thus ensuring level playing field and benefiting EU CSDs. Outside the EU: end date of the grandfathering clause for third-country CSDs would ensure level playing field with third-country CSDs, benefiting EU CSDs.
Additional opportunities for CSDs that do not hold a banking license.	It is estimated that additional EUR 16 billion settlement in foreign currencies could be expected annually[280]. If extrapolated to the total number of EEA non-banking CSDs, this could mean an **additional annual possible offering of at least EUR 80 billion[281] of settlement in foreign currencies**.	Increasing the threshold could enable some CSDs to develop their services to investors both domestically and cross-border, benefitting investors and issuers through a more competitive offering.
More proportionate approach to the treatment of settlement fails.	**Delayed implementation costs for investors and issuers** with a postponement in the introduction of the mandatory buy-in: estimated at **ca. EUR 1.5 billion**.[282] **Reduction of annual operational/ subscription fees for connecting to a buy-in agent** to handle government bond fails in one CSD, estimated between EUR 598 900 294 and EUR 1 197 800 588, according to one estimate.[283]	Average cost per market participant to set up a connection to a buy-in agent is estimated, on average to be EUR 1 million, based on stakeholder input. This results in a total figure of EUR 1.5 billion for all in-scope EU market participants[286]. Such costs savings could be temporary (i.e. until the buy-in regime enters into force) or permanent (e.g. if conditions for the entry into force of the

[280] Based on anonymised confidential information provided to DG FISMA services. This figure is based on the current total absolute value of settlement of CSDs and applied to potential growth in settlement of CSDs. This gives an anticipated total of settlement in foreign currencies. The current absolute values in foreign currencies are then subtracted, which gives the anticipated total net gain from the proposed CSDR changes.

[281] This estimate of benefits does not take into account whether it would affect existing settlement in foreign currencies undertaken by CSDs already authorised to provide ancillary banking services.

[282] This is supported by confidential information provided to DG FISMA services.

[283] Data provided by ICMA in its response the CSDR targeted consultation, https://www.icmagroup.org/assets/documents/Regulatory/Secondary-markets/CSDR-Settlement-Regulation/ICMACSDR-Review-Targeted-ConsultationFeb-21Detailed-response-020221.pdf..

	Introduction of a pass-on mechanism could reduce costs by 37.5%, according to one estimate[284]. Deferred introduction of mandatory buy-in will prevent some trading volumes disappearing or migrating outside the EU (Estimated at up to 4% - 5% of trade volume, equal to EUR 7 trillion annually[285]).	buy-in regime are never met). The targeted amendments contemplated for cash penalties and mandatory buy-in would also bring necessary clarifications and reduce the complexity and the burden of managing a buy-in process, hence reducing costs for investors, market infrastructure providers and authorities alike.
Improved supervisory capabilities for ESMA and NCAs.	No estimate available.	ESMA and NCAs would have more information and would be able to better identify and monitor risks. Amendments to the pass-on mechanism would mean fewer buy-ins and would contribute to market stability.
Indirect benefits		
Increased protection of issuers and investors.	No estimate available.	Enhanced supervision of EU CSDs through the establishment of colleges and of third-country CSDs through the end-date for the grandfathering clause and the introduction of the notification requirements would lead to improved supervision of CSDs and thus a better protection of issuers and investors.
Increased transparency in the market.	No estimate available.	The implementation of a notification requirement by third-country CSDs regarding the activities they carry out within the EU and/or with EU participants would also indirectly benefit market stability, as it would help identify which third-country CSDs provide services and in which volumes, thus increasing transparency in the market and help identify potential systemic risk.
Increased competition between CSDs regarding the provision of settlement services is foreign	No estimate available.	Issuers and investors would have more choice in terms of financing arrangements, issuance and risk diversification in their

286 Confidential information provided to DG FISMA.

284 For explanation and calculation of costs savings see J.P. Morgan public consultation reply, Q. 34.1.

285 Based on confidential data provided to DG FISMA services indicated that 4%-5% of trade volume could cease to occur. Annual equity and equity-like instrument trading volumes and bond trading volumes were equal to EUR 128 trillion end-2019 (See chapter "1.3.2 Size of the market" of the Impact Assessment), giving a figure of up to EUR 7 trillion.

currencies, benefitting investors and issuers.		cross-border investments.
Reduction of administrative burden related to the development of Q&As.	No estimate available.	Clarifications regarding the settlement discipline regime (penalties and buy-in) would lessen the administrative burden on ESMA related to replying to Q&A's.
Streamlined cooperation of authorities.	No estimate available.	Ongoing costs will be reduced for NCAs due to the streamlined cooperation of authorities through the creation of colleges.

II. Overview of costs – Preferred option							
		Citizens/Consumers [Investors/ Issuers]		Businesses [Market Infrastructure providers, CSDs]		Administrations [NCAs, ESMA]	
		One-off	Recurrent	One-off	Recurrent	One-off	Recurrent
Replacing of passporting at the host Member State level with a notification	Direct costs	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact apart from (neglible) costs changing current procedures.	Marginal costs to assess notifications.
	Indirect costs	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact
Establish colleges	Direct costs	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact	Establishment of colleges EUR 260000
	Indirect costs	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact
Targeted amendment	Direct costs	No cost	No cost	No cost	No cost	No cost impact as	No cost impact as

to allow banking CSDs to offer services to other CSDs		impact	impact	impact	impact	within current supervisory arrangements	within current supervisory arrangements
	Indirect costs	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact
Amend threshold for banking services	Direct costs	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact as within current supervisory arrangements	No cost impact as within current supervisory arrangements
	Indirect costs	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact
Targeted amendment to settlement discipline regime	Direct costs	Marginal compliance costs to the clarified rules, i.e. removing out-of-scope transactions and setting up a pass-on mechanism.	No cost impact.	Marginal compliance costs to the clarified rules. In case of compliance costs to amended buy-in rules, these can become sunk cost (if mandatory buy-in will be abandoned).	No cost impact.	No cost impact.	Reduction of costs related to settlement monitoring and compliance, guidance provided to market participants.
	Indirect costs	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact
Deferred introduction of mandatory	Direct costs	No cost impact	No cost impact	Costs related to the setting up of a mandatory buy-in (i.e. setting up or connecting to a	Some reporting costs as CSDs will need to provide more accurate and timely data as	No cost impact	Some costs related to settlement fail monitoring, occassional

buy-in				buy-in agent) may prove to be sunk costs if mandatory buy-in is abandoned.	to the evolution of settlement efficiency to support decision on the implementation of mandatory buy-in.		ly going beyond current requirements, and assessment of the evolution of fail rate to support decision on the implementation of mandatory buy-in.
	Indirect costs	Setting up cost for collecting cash penalties, but this is largely already prepared by the market participants.	Higher cost of financial transactions that enter delayed settlement (Cash penalties added to a transaction cost)[287]. These cost are manageable for the market.	Cost related to the implementation of cash penalties. These costs are marginal and largely implemented.	No cost impact	No cost impact	Potential costs related to determining the need and terms of introduction of mandatory buy-in.
Ending the grand-fathering clause	Direct costs	No cost impact	No cost impact	Third-country CSDs would incur costs attributed to seeking authorisation from ESMA.	Third-country CSDs would incur recurrent additional costs related to compliance with relevant EU rules (in case third country rules are deemed not equivalent with EU rules) and	Marginal costs for ESMA related to setting up procedure for handling equivalence decisions from third-country CSDs.	Marginally increased costs for ESMA for handling authorization requests from third-country CSDs.

[287] The initiative supported by this Impact Assessment does not introduce cash penalties, so its costs cannot be directly attributed to it. However, the costs of cash penalties in terms of impact on market pricing have not been incurred as cash penalties have not yet entered into force.

					potentially operating two settlement regimes (a EU one and a third country one).		
	Indirect costs	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact
Notification requirement for third-country CSDs	Direct costs	No cost impact	No cost impact	Third-country CSDs would incur costs attributed to the notification process with ESMA.	No cost impact	Marginal costs for ESMA related to setting up procedure for handling third-country CSD notifications.	Marginally increased costs related to handling new notifications. ESMA estimated costs for one third-country CSD notification would amount to ca. EUR 2 600 per notification.
	Indirect costs	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact	No cost impact

ANNEX 4: ANALYTICAL METHODS

The analysis carried out as part of the impact assessment is based on three methodological approaches:

1. desk research;
2. qualitative analysis and;
3. quantitative analysis.

The data used to calculate the expected benefits and costs stem from a variety of different data sources. Sources include in particular the targeted consultation that ran from December 2020 to February 2021, stakeholder meetings (such as with the European Central Securities Depositories Association (ECSDA) and other direct contributions (including confidential ones) received. Additional data was collected from publicly available sources (e.g. websites and annual statements of CSDs) and from the European Securities Markets Authority (ESMA).

The analysis is strongly based on cost estimates provided by both supervisors, market participants and CSDs. In some cases, the data analysed cannot be publicly distributed given an extremely limited number of datapoints on specific market actors. Making such information public may allow identification of the contributor. Publication of this data could provide information to active or potential competitors which may allow them to gain insights as to cost functions and other sensitive corporate information, thus leading to unfair competitive advantages. This data has been considered by the Commission in its analysis and the results are reflected qualitatively in this impact assessment. To that end, respective figures have been presented in the Impact Assessment to the Regulatory Scrutiny Board as part of the impact assessment scrutiny process as coming from confidential contributions. Some data has been removed afterwards as the publication would lead to identification of the contributor.

The presented analysis faces several methodological limitations. In particular, no meaningful estimates can be provided as to the increase in competition between CSDs and resulting lower costs that would occur under the preferred policy options. Estimates are provided only in terms of cost savings for cross-border entry of CSDs under a new passporting regime. While the Commission expects a clear increase in competition, the market impact will ultimately depend on respective corporate decisions of CSDs to engage in cross-border market entry.

Likewise, in the area of banking services, the number of banking CSD is at present very limited (5), as, but to a lesser extent, the non-banking CSDs. This, in combination with a lack of data, makes the meaningful estimation on the effects of the presented options difficult to provide and qualitative information was used and presented to make the case for the presented preferred options. While the Commission does expect these benefits to materialize, these will also depend on future business decisions taken by the respective CSDs.

Likewise, the possible impact of the mandatory buy-in regime, if and when implemented, cannot be clearly specified. The presented analysis is based on input received from both market participants and supervisors. Limitations exists in particular as concerns the possible impact on market liquidity and volatility. Since the regime is not presently in application, all data collected in relation to these market impacts is based on modelling. This data nonetheless provides a good indication of the expected effects. Other data on costs (e.g. connection to buy-in agents) provides further support for the preferred policy option.

ANNEX 5: EVALUATION

Section 1 Executive Summary

The Central Securities Depositories Regulation (CSDR – Regulation 909/2014) is an essential element of safe, stable and efficient EU capital markets. It offers a framework for the settlement of securities transactions ensuring that buyers receive securities and sellers receive payment after a securities transaction is agreed upon. Other services performed post-trade typically include clearing (guaranteeing performance by ensuring there is a buyer to every seller and a seller to every buyer) and post-trade reporting (where individual transactions and/ or positions of participants are kept track of).

Post-trade services are an integral part of the value chain, as they ensure that a transaction is completed, i.e. transfering ownership of a security from one party to another, and transfering cash as payment. Post-trade services are provided by financial market infrastructures, i.e. Central Counterparties (CCPs), trade repositories, sometimesby banks (including custodians) and Central Securities Depositories (CSDs).

CSDs, together with central counterparties (CCPs), help safeguard financial markets and give market participants confidence that securities transactions are executed properly and in a timely manner, including during periods of extreme stress. Due to their key position in the settlement process, the securities settlement systems operated by CSDs are of systemic importance for the functioning of securities markets. Playing an important role in the securities holding systems through which their participants report the securities holdings of investors, the securities settlement systems operated by CSDs also serve as an essential tool to control the integrity of an issue, hindering the undue creation or reduction of issued securities, and thus playing an important role in maintaining investor confidence. Moreover, securities settlement systems operated by CSDs are closely involved in securing collateral for monetary policy operations as well as in securing collateral between credit institutions and are, therefore, important actors in the collateralisation process.

CSDR was the EU's response to the call of the Financial Stability Board, on 20 October 2010, for the revision and enhancement of the existing standards to ensure more robust financial market infrastructures.[288] It took into account the global standards for financial market infrastructures set by the Committee on Payments and Settlement Systems (CPSS) of the Bank of International Settlements (BIS) and the International Organisation of Securities Commissions (IOSCO) in April 2012.[289] CSDR entered into force on 17 September 2014 with some parts, notably the part on settlement discipline, entering into force with a delayed application, on 1 February 2022.

CSDR has been included in the 2021 Commission's Regulatory Fitness and Performance programme (REFIT). Inclusion in the REFIT programme was justified by the need to simplify targeted areas of CSDR and make them more proportionate, as evidenced by the contributions to the public consultation on CSDR[290], as well as by the Commission's review of the application of CSDR, carried out in accordance with Article 75 of CSDR.[291]

[288] https://www.fsb.org/wp-content/uploads/pr_101020.pdf
[289] https://www.bis.org/cpmi/publ/d101.htm
[290] https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en
[291] https://ec.europa.eu/info/publications/210701-csdr-report_en

In this context, the purpose of this evaluation is to assess to what extent specific policy requirements in CSDR have met their objectives and in particular whether these requirements have done so in an efficient and effective way, while at the same time ensuring that CSDR is coherent, relevant and providing EU added-value.

Given that some of the core requirements of CSDR have only recently become applicable or are not applicable yet, this assessment does not constitute a full evaluation of CSDR, due to the lack of adequate evidence and as it is too early to draw a firm conclusion on long-term impacts. Instead, the evaluation assesses the core requirements of CSDR:

- shorten settlement periods and set cash penalties and other deterrents for settlement fails;
- ensure stability of CSDs by setting strict organisational, conduct of business and prudential requirements for CSDs;
- allow authorised CSDs to provide their services across the EU;
- increase prudential and supervisory requirements for CSDs and other institutions providing banking services that support securities settlement.

Given that the evaluation has been conducted in parallel with the CSDR review, it has fed into the problem definition of the impact assessment (IA) accompanying the CSDR REFIT initiative, and is presented as an Annex to the IA on the CSDR Review.

This evaluation is based primarily on the results of consultations with stakeholders, regular exchanges with Members of the European Parliament and experts from the Member States, reports from and discussions with the European Securities and Markets Authority (ESMA), the European Systemic Risk Board (ESRB), and the European System of Central Banks (ESCB), and additional desk research of the Commission services. More specific sources included:

- the CSDR review report of 1 July 2021[292];
- the targeted public consultation of 8 December 2020[293];
- the feedback statement related to the targeted consulation[294];
- reports from ESMA on the implementation of CSDR[295], as required by Article 74 of CSDR and various input received from a wide array of stakeholders;

On the basis of the above-mentioned evidence, this evaluation has considered the following five criteria to assess the core requirements of CSDR, in accordance with the Better Regulation guidelines:

- Efficiency;
- Effectiveness;

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[292] CSDR review report (see note 9).

[293] https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en

[294] https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2020-csdr-review-summary-of-responses_en.pdf

[295] reports on the CSDR Review. See: On 5 November 2020, it published a report on internalised settlement: https://www.esma.europa.eu/sites/default/files/library/esma70-156-3729_csdr_report_to_ec_-_internalised_settlement.pdf. Also on 5 November 2020, it published its report on the provision of CSD cross-border services and handling of related applications: https://www.esma.europa.eu/sites/default/files/library/esma70-156-3569_csdr_report_to_ec_-_csd_cross-border_services.pdf. On 8 July 2021 it published its report on the provision of banking-type ancillary services: https://www.esma.europa.eu/sites/default/files/library/esma70-156-4582_report_to_the_ec_-_csdr_banking_services.pdf and ; Report to the European Commission: use of Fintech by CSDs, ESMA, 2 August 2021: https://www.esma.europa.eu/sites/default/files/library/esma70-156-3569_csdr_report_to_ec_-_csd_cross-border_services.pdf.

- Relevance;
- Coherence;
- Added-value of EU action.

This evaluation conludes the following:

- On the **effectiveness and efficiency** of the core requirements of CSDR, it indicates that while the volume of settled trades increased since the entry into force of CSDR, cross-border transactions remained stable and feedback from stakeholders indicate that in several areas, e.g. passporting, licensing, and supervisory assessments, significant barriers exist and preliminary findings suggest that actions **(i) to reduce disproportionate compliance burdens, (ii) to improve cross-border activity could be undertaken.** Improvements could also be sought in the area of banking services, where the access to banking-type ancillary services is limited which in turn inhibits settlement in foreign currencies and in improvement of supervision, both impacting the possibilities or opportunities for firms to offer services cross-border.
- The objectives of CSDR to increase the safety and efficiency of EU settlement market and ensuring a level playing field for CSD services **remain relevant**, and associated risks with EU settlement markets persist.
- In terms of **coherence**, CSDR is aligned with international efforts ensure stability and safety of post-trade infrastructures. In addition, CSDR is coherent with other pieces of EU legislation, such as the Commission's Capital Market Union Action Plan, EU securities and banking regulations, as well as the Commission's proposal to introduce a pilot regime for technological innovations of CSDs and DORA.
- In terms of the **EU added value**, CSDR covered a gap that existed in legislation by introducing a new framework aiming to address, in a uniform process at EU level, the lack of a harmonised approach towards the EU's settlement markets and in addressing the related systemic risks.

Section 2 Introduction

CSDR entered into force on 17 September 2014. It aims to maintain safe and trustworthy post-trade infrastructures that safeguard financial markets and provide market participants confidence that securities transactions are executed properly and in a timely manner, including during periods of extreme stress.

CSDR lays down the core requirements for the EU's settlement markets. These include common requirements for CSDs across the EU and provide inter alia rules on:

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

In accordance with Article 75 of CSDR, the Commission was mandated to carry out a review of the application of CSDR and to present any appropriate legislative proposals. In this context, the Commission has carried out an assessment of the rules currently in place, based in particular on a targeted public consultation and input from various stakeholders, carried out by DG FISMA in the course of 2020 and the first half of 2021. On 1 July 2021, the Commission adopted a report on the review of CSDR (the CSDR review report)[296]. The report identified areas for which targeted action is necessary to ensure fulfilment of the CSDR objectives in a more proportionate, efficient and effective manner.

Certain of core requirements of CSDR have not yet been implemented or the implementation is incomplete. In particular, at this stage, the rules around settlement discipline are not yet applicable and are scheduled to enter into application on 1 February 2022. As such, due to the lack of adequate evidence, the evaluation cannot assess holistically and with historical data all elements of the impact of CSDR.

Nevertheless, the CSDR review report already identifies a number of issues relating to the implementation of those requirements that already apply (namely, (1) passporting requirements, (2) cooperation amongst authorities and supervisory convergence, (3) banking services related to settlement, especially to foreign currencies, (4) aspects of the settlement discipline framework, in particular mandatory buy-ins, (5) the framework for third-country CSDs).

In addition, under Article 81(2c) of Regulation (EU) 2010/10 establishing a European Supervisory Authority (European Securities and Markets Authority), the Commission is required, after consulting all relevant authorities and stakeholders, to conduct a comprehensive assessment of the potential supervision of third-country CSDs by ESMA exploring certain aspects, including recognition based on systemic importance, ongoing compliance, fines and periodic penalty payments.

In accordance with the CSDR review report and further analysis conducted in this evaluation, the Commission considers proposing a targeted legislative initiative on CSDR. This initiative is part of the Commission's Regulatory Fitness and Performance programme (REFIT) and included in the Commission Work Programme[297] and the 2020 Capital Markets Union Action Plan.[298]

In this context, the purpose of this evaluation is to assess to what extent specific policy requirements in CSDR have met their objectives and in particular whether these requirements have done so in an efficient and effective way, while at the same time being coherent, relevant and providing EU added-value. The evaluation has fed into the problem definition of the impact assessment (IA).

Section 3 Background to the initiative

[296] Report from the Commission to the European Parliament and the Council under Article 75 of Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, COM(2021) 348 final, 1 July 2021: https://ec.europa.eu/finance/docs/policy/210701-csdr-report_en.pdf

[297] Commission Work Programme 2021 (see note 244).

[298] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions "A Capital Markets Union for people and businesses-new action plan", COM (2020) 590 final.

Description of the initiative and its objectives

CSDR was published in the Official Journal of the European Union on 28 August 2014, and entered into force on 17 September 2014. Some of the requirements did not immediately become applicable, as CSDR empowered the Commission to adopt secondary legislation specifying technical modalities and a phase-in of some requirements. As a result, requirements to adress settlement fails will only start to apply from 1 February 2022.[299] Other elements of CSDR that have later entry dates are the requirement to issue in book-entry form,[300] the shortening of the settlement period to 2 days after the conclusion of the securities transaction[301] and certain reporting requirements that were made dependent on the entry into force of the technical secondary legislations.

Recital (5) of CSDR provides a description of the objectives of the Regulation:

"*It is necessary to lay down in a regulation a number of uniform obligations to be imposed on market participants regarding certain aspects of the settlement cycle and discipline and* ***to provide a set of common requirements for CSDs operating securities settlement systems****. The directly applicable rules of a regulation should ensure that all market operators and CSDs are subject to identical directly applicable obligations, standards and rules.* ***A regulation should increase the safety and efficiency of settlement in the Union*** *by preventing any diverging national rules as a result of the transposition of a directive. A regulation should* ***reduce the regulatory complexity*** *for market operators and CSDs resulting from different national rules and* ***should allow CSDs to provide their services on a cross-border basis*** *without having to comply with different sets of national requirements such as those concerning the authorisation, supervision, organisation or risks of CSDs. A regulation imposing identical requirements on CSDs should also contribute to eliminating competitive distortions.*"

CSDR seeks to increase the safety and improve settlement efficiency as well as provide a set of common requirements for CSDs across the EU while reducing systemic risk through the application of its core requirements, which include:

1. shorter settlement periods and cash penalties and other deterrents for settlement fails;
2. strict authorisation, organisational, conduct of business and prudential requirements for CSDs;
3. a passport system allowing authorised CSDs to provide their services across the EU;
4. increased prudential and supervisory requirements for CSDs and other institutions providing banking services that support securities settlement;
5. increased cooperation requirements for authorities across Member States with respect to CSDs providing their services in relation to financial instruments constituted under the law of a Member State other than that of their authorisation and to CSDs establishing a branch in another Member State.

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299 Originally intended to apply from 1 February 2020, the entry into force was twice delayed upon proposal by ESMA: esma70-156-3490_final_report_-_csdr_rts_on_settlement_discipline_-_postponement_until_1_february_2022.pdf.

300 Article 3(1) CSDR: from 1 January 2023 for transferable securities issued after that date and from 1 January 2025 to all transferable securities.

301 Article 5(2) CSDR: application from 1 January 2015.

Thus, CSDR plays a pivotal role in the post-trade harmonisation efforts in the EU, enhancing the legal and operational conditions in particular for cross-border settlement in the Union, while promoting cross-border competition and financial stability.

CSDR seeked to address the three main problems identified in the impact assessment that accompanied the CSDR proposal in 2014[302] related to the functioning of the EU's settlement markets: (i) higher risk for cross-border (compared to domestic) settlement; (ii) higher cost for cross-border settlement; and (iii) unlevel playing field for CSD services. These issues followed from ultimately three main drivers: (1) different market practices on the organisation of settlement; (2) different rules for CSDs across the EU; and (3) barriers of access to/from CSDs.

The **strategic objectives** of CSDR were to tackle the three key consequences of the problems identified in the previous section by:

(1) Increasing safety of the EU settlement market;

(2) Increasing efficiency of the EU settlement market;

(3) Ensuring level playing field for CSD services.

These strategic objectives translated into a number of **specific objectives**, as follows:

- Reduce the complexity of cross-border settlement – this should increase both safety and efficiency of cross-border settlement;
- Reduce risk of arbitrage to the "softest" market practice (in terms of settlement discipline) – this should increase the safety of settlement in general;
- Ensure consistent definition of CSD services across the EU – this should improve level playing field between CSDs, as well as increase safety;
- Reduce the fragmentation of post-trading markets – this should increase both safety and efficiency of cross-border settlement;
- Reduce the scope for national monopolies – this should improve the level playing field for CSD services and increase competition between CSDs and between CSDs and intermediaries.

These specific objectives were to be achieved by a number of **concrete operational objectives**, which were grouped in the following three categories:

(1) Enhance framework for settlement in the EU – by improving cross-border settlement discipline and harmonizing settlement periods;

(2) Introduce consistent rules for CSDs across the EU – such rules refered to both the prudential and organisational rules to ensure the safety, efficiency and level playing field of CSDs, as well as the licensing framework, to ensure the level playing field and competition among CSDs;

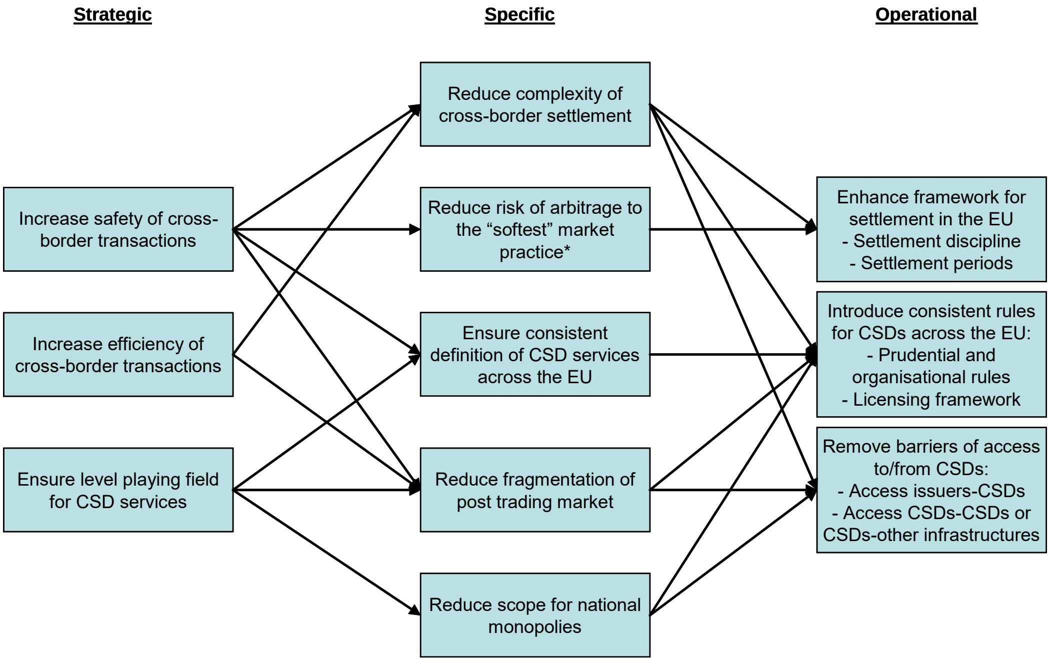
(3) Remove barriers of access to/from CSDs – this refers to both access between issuers and CSDs as well as between the CSDs themselves and between CSDs and other market infrastructures such as trading venues and CCPs.

An overview of the various objectives and their interconnectedness is depicted below in **Figure 1.** It also provides a description - in a summarised diagram format - on how

[302] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD%3A2012%3A0023%3AFIN

CSDR was expected to work and the intervention logic. This evaluation uses it as a structure carry out the evaluation and answer specific questions.

Figure 1: Overview of objectives



Nb: the arrows represent the key interrelationships. Most factors represented above are in fact interlinked. * refers to a competitive environment.

Description of the situation before the adoption of CSDR

Against the background of the ongoing financial crisis, around 2008 various international institutions pleaded to strenghten ensuring safe and sound post-trade infrastructures inbuilding a safer, more stable and efficient global financial system. To that effect the Council urged to step up the EU ambitions for post-trade infrastructures with emphasis on safety and soundness, whereby it noted that "the reality of a single European securities market is not compatible with a fragmented European post-trading sector. Achieving competitive, efficient and safe pan-European post trading arrangements is becoming more and more critical".[303]

It was noted that CSDs are systemically important market infrastructures. Firstly, they intervene throughout the life span of securities, from issuance to reimbursement. Secondly, they perform, sometimes after prior netting by Central Counterparties (CCPs), most of the processes that lead to the settlement of a transaction, i.e. the delivery of securities against cash. In addition, CSDs play a crucial role in the transmission of monetary policies. Concrete cases at the time that urged action were the Lehman and Bear Stearns cases, where difficulties were encountered in terms of the ownership of securities as well as the number of outstanding securities (more securities with counterparties than issued).

Before the entry into force of the CSDR there was no central EU regulation where this subject matter was regulated, although a number of topics were addressed in different regulations, such as SFD, MIFID.

[303] https://data.consilium.europa.eu/doc/document/ST-16212-2008-INIT/en/pdf

At the time, securities transactions in Europe were already becoming increasingly cross-border and was expected to increase once the Target2 Securities (T2S)[304] pan-European common settlement platform would start. Despite this, cross-border securities settlement in Europe remained complex due to different – highly fragmented along national lines – market practices regarding settlement as well as to persisting barriers of access. This had implications for the safety and efficiency of cross-border securities transactions. For instance, costs of cross-border settlement were about 4 times more costly as within national borders.[305]

In the EU in 2010, over 330 million securities transactions were settled by CSDs, for a total value of approximately €920 trillion. EU CSDs held almost €39 trillion of securities at the end of 2010.

The IA in 2010 identified several problems relating to the functioning of the EU settlement markets, which included: (i) higher risk for cross-border (compared to domestic) settlement, (ii) higher cost for cross-border settlement and (iii) unlevel playing field for CSD services.

CSDR was adopted to address these problems by setting out the measures as identified above.

Section 4 Evaluation Questions

This section summarises the review questions addressed in this evaluation.

Question 1: How effective has the EU intervention been?

- To what extent have the objectives of CSDR to: (1) increase safety of cross-border transactions; (2) increase efficiency of cross-border transactions and (3) ensure level playing field for CSD services been achieved and what factors influenced the achievements observed?

Question 2: How efficient has the EU intervention been?

- To what extent have CSDR's core requirements on settlement discipline, organisational, conduct of business and prudential requirements for CSDs, the passport system, increased prudential and supervisory requirements and increased cooperation requirements given the effects they have achieved in promoting an EU settlement market and in mitigating systemic risk?

Question 3: How relevant is the EU intervention?

- To what extent are CSDR's requirements on settlement discipline, organisational, conduct of business and prudential requirements for CSDs, the passport system, increased prudential and supervisory requirements and increased cooperation requirements still relevant to promote an EU settlement market and the stability of the financial markets and in light of current developments in this market?

Question 4: How coherent is the EU intervention?

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[304] See T2S website for more details http://www.ecb.int/paym/t2s/html/index.en.html

[305] Commission Staff Working Document, "Impact Assessment accompanying the proposal for a regulation on improving securities settlement in the European Union and on Central Securities Depositories (CSDs)", SWD (2012) 22 final, p.58.

- To what extent are CSDR's requirements on settlement discipline, organisational, conduct of business and prudential requirements for CSDs, the passport system, increased prudential and supervisory requirements and increased cooperation requirements coherent with other pieces of EU financial legislation.

Question 5: What is the EU-added value of the intervention?

To what extent have CSDR's requirements on settlement discipline, organisational, conduct of business and prudential requirements for CSDs, the passport system, increased prudential and supervisory requirements and increased cooperation requirements helped increasing safety of cross-border transactions, increasing efficiency of cross-border transactions; ensuring level playing field for CSD services and to what extent do the risks relating to the markets continue to require action at EU level?

Section 5 Methodology

This evaluation is based primarily on the results of consultations with stakeholders, reports from the European Securities and Markets Authority (ESMA), various inputs from different stakeholders and additional desk research of the Commission services. More specific sources included:

- the CSDR review report[306];
- a targeted public consultation seeking feedback on a range of specific areas where targeted action may be necessary to ensure the fulfilment of the objectives of CSDR in a more proportionate, efficient and effective manner as mandated by Article 75 CSDR.[307] This consulation took place from 8 December 2020 until 2 February 2021 and received 91 responses from a broad range of stakeholders across the EU as well as from third-countries. A detailed summary of the responses to the two consultations is provided in the feedback statement to the consultation.[308]
- Reports from ESMA[309], as required by Article 75 of CSDR.

In addition to these sources, input from the European Parliament as well as from dedicated meetings with Member States was also considered. In particular, a resolution by the European Parliament on stocktaking and challenges of the EU Financial Services Regulation: impact and the way forward towards a more efficient and effective EU framework for Financial Regulation and a Capital Markets Union, adopted in January 2016[310]. The Commission services also engaged in exchanges with MEPs from the ECON Committee involved in the CSDR review.

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306 Report from the Commission to the European Parliament and the Council under Article 75 of Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, COM(2021) 348 final, 1 July 2021: https://ec.europa.eu/finance/docs/policy/210701-csdr-report_en.pdf

307 Feedback to the targeted consultation by the European Commission: https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en

308 https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2020-csdr-review-summary-of-responses_en.pdf.

309 See notes 50, 86, 88, 89.

310 European Parliament Resolution 2015/2106 (INI) of 19 January 2016.

The Commission services also participated in various meetings and working groups of the ESCB as well as ESMA where post-trade developments are discussed.

Limitations – robustness of findings

While CSDR entered into force on 17 September 2014, certain core requirements (including those on settlement discipline) provided for in the Regulation are yet to be implemented or completed. This has a number of consequences.

First, it means that a full evaluation of the effectiveness and efficiency of CSDR in meeting its objectives is not possible.

Second, there is only a limited amount of quantitative evidence available to carry out the evaluation, as the experience drawn from the applicable requirements only spans a couple of years. In the specific instance of settlement discipline, for example, there is no data available, as the regime is only scheduled to apply from February 2022.

Nevertheless, the evaluation draws from the data collected by European public authorities and bodies (i.e. ESMA, ESCB) on the basis of rules which are already in place as well as the responses to the public consultation and contacts and sometimes concerns by external stakeholders. In addition, it is important to highlight that the market for settlement is yet, only a few years after entering into force, still fragmented, with many local specificities in legal, taxation and other administrative areas so that comparisons are highly difficult to make. This entails that in some areas proxies and assumptions have been made.

Section 6 Implementation state of play (Results)

Overview of requirements in place

As mentioned, CSDR has been directly applicable since 17 September 2014. A Regulation was deemed to be the most suitable policy instrument to ensure the application of uniform requirements throughout the EU with exactly the same scope, without any gold-plating and without allowing residual powers to Member States. In addition, CSDR empowered the Commission to adopt delegated acts in accordance with Article 290 TFEU to specifying some requirements and implementing acts in accordance with Article 291 TFEU to ensure the uniform conditions of implementation. CSDR also required ESMA to prepare draft regulatory technical standards and implementing technical standards, to be adopted by the Commission, and carry out appropriate impact assessments pursuant to Regulation (EU) No 1095/2010.

This section focuses on the application of those rules that are relevant to achieve CSDR's objectives to increase safety of the EU settlement market, increase efficiency of the EU settlement market and ensure a level playing field for CSD services.

The following key obligations have started to apply with respect to these three objectives:

- <u>Increasing efficiency of the EU settlement market:</u> shortening settlement times from T+3 to T+2 and a passporting regime to enable CSDs their services across the EU.
- <u>Increasing safety of the EU settlement market:</u> authorisation, organisational, conduct of business and prudential requirements for CSDs, integrity of issue requirements, part of the settlement discipline measures (where CSDs have to

have internal processes and procedures in place as well as external contractual measures in place to facilitate timely settlement) and a framework for the provision of banking services by CSDs.

- Ensuring level playing field for CSD services: a passporting framework, a framework for supervisory cooperation and a framework for third-country CSDs.

These rules are in place across EU Member States as well as the European Economic Area ('EEA'). As with any other EU Regulation, its provisions are directly applicable (i.e. legally binding in all Member States without transposition into national law) as from the day of entry into force.

Not all of the requirements of CSDR already apply. Many provisions of CSDR, in particular when taken together with the implementation dates included within the different technical standards, result in a phased-in application of the legal framework. This is notably the case of the reporting, penalties and buy-in requirements of the settlement discipline regime, for which entry into force has been postponed twice. These requirements are currently scheduled to apply from 1 February 2022.

These requirements should be considered within the relevant objectives of CSDR.

What is the current situation?

1. **Requirements aimed at increasing efficiency of the EU settlement market**

An important achievement of the CSDR is that settlement periods are reduced to T+2. The settlement period was harmonised in the EU and set at a maximum of two days after the trading day (T+2). A harmonised settlement period aims to reduce operational inefficiencies and risks for cross-border transactions, while reducing funding costs for investors (i.e. for those that have to deliver cash or securities at T+3 but can only receive them at T+2). Shorter settlement periods has an important advantage of reducing counterparty risk, that is, the period of time during which an investor runs a risk that its counterparty will default on its obligation to deliver cash or securities at the agreed settlement date.

A core objective of CSDR was the creation of a single market for CSDs. CSDR creates a passporting regime whereby CSDs may provide their services in the EU without the need for further local authorisation. When a CSD provides its services in a Member State other than where it is established, the competent authority of the home Member State is responsible for the supervision of that CSD. However, the procedure through which a CSD authorised in an EU Member State can provide notary and central maintenance services in relation to financial instruments constituted under the law of another EU Member State or to set up a branch in another Member State is based on the cooperation of the CSD's home Member State competent authority with the host Member State competent authority. In that case, the home Member State competent authority bears the primary responsibility to determine the adequacy of the administrative structure and the financial situation of the CSD wishing to provide its services in the host Member State. The host Member State competent authority shall however approve a part of the passporting file consisting of the description of the measures that the requesting CSD will implement in order to allow its participants to comply with the relevant provisions of the corporate or similar law of the home Member State.

Despite the fact that most of the applying CSDs have been able to obtain a "passport" to offer notary and central maintenance services in one or several other Member States, anecdotal information from stakeholders has indicated that this process has been significantly more burdensome than previously thought. The majority of CSDs considered that the passporting process has not prevented CSDs from offering issuer CSD services for securities constituted under the laws of another Member State as such, but has slowed down their ambitions. Certain CSDs noted that they had to withdraw some passport requests due to, what they perceived to be national constraints, e.g. compliance with the direct individual segregation model applicable under national law.[311]

Finally, CSDR introduced rules on settlement discipline to prevent and address failures in the settlement of securities transactions and therefore ensure the efficiency of transaction settlement. The two main elements of the settlement discipline regime are cash penalties and mandatory buy-ins. All CSDs would be required to impose cash penalties on their participants in case of settlement fails. If despite the cash penalties, a CSD participant (original seller) would fail to deliver the securities it would be subject to a mandatory buy-in. A buy-in provides the buyer of securities with the right to buy the securities elsewhere, cancel the original transaction and put the costs of the buy-in, as well as any price difference, with the original seller. The settlement discipline regime also imposes requirements on the reporting of settlement fails by the CSDs.

Since 2017, ESMA has frequently updated its CSDR Q&A's on settlement discipline regime, with currently 7 Q&A's related to settlement discipline.[312] More than 25 Q&As on settlement discipline are however being assessed at this point in time.

The settlement discipline regime was due to enter into force on 13 December 2020 but was postponed twice: (1) to 1 February 2020 (this short delay, based on a proposal by ESMA, was considered necessary to take into account the additional time needed for the establishment of some essential features for the functioning of the new framework); (2) due to the impact of the Covid-19 pandemic, ESMA[313] decided to propose postponing the date of entry into force of a CSDR Regulatory Technical Standards (RTS) on settlement discipline[314] until 1 February 2022.

Despite the absence of experience in applying the rules, the development and specification of the framework in the relevant regulatory technical standard has allowed all interested parties to better understand the regime and the challenges its application could give rise to, especially at times of crisis, e.g. such as the COVID-19 crisis in spring 2020.

Despite the lack of complete data in this respect due to lack of mandatory reporting, it seems that settlement fails rates have remained stable in the EU since 2018 (approx. 6% for equities and 3% for bonds[315]) in a context of the dramatic increase in trading (settlement instructions increased by 30% between 2015 – 2019 in EU CSDs[316]), but still remain higher than other jurisdictions (in particular, higher than in the US where roughly 2% of all US treasuries and mortgage backed securities transactions fail[317]). The

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[311] Feedback to the targeted consultation by the European Commission: https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en

[312] CSDR Q&As (see note 164).

[313] ESMA proposes to further postpone CSDR settlement discipline (europa.eu): https://www.esma.europa.eu/press-news/esma-news/esma-proposes-further-postpone-csdr-settlement-discipline.

[314] RTS on settlement discipline.

[315] "ESMA Report on trends, risks and vulnerabilities", European Securities and Markets Authority, ESMA-50-165-1287, No. 2, 2 September 2020.

[316] Data generated through the Securities Trading, Clearing and Settlement Statistics Database, European Central Bank. Accessed on 29 April 2021. Available at: https://sdw.ecb.europa.eu/browse.do?node=9691131.

[317] K. Burne, 'How to succeed in fixing settlement fails', Aerial View, Bank of New York Mellon, 2020.

forthcoming entry into force of the settlement discipline regime is expected to further improve such rates. But it is yet to be determined what the exact impact of each requirement of this regime (i.e. reporting, penalties and buy-in requirements) will be.

2. Requirements aimed at increasing safety of the EU settlement market

CSDs are subject to authorisation by the competent authorities of their home Member Sate which examine how CSDs operate on a daily basis, carry out regular reviews and take appropriate action when necessary. Under Articles 16 and 54 of CSDR, CSDs should obtain an authorisation to provide core CSD services as well as non-banking and banking-type ancillary services. Article 69(4) however allows CSDs authorised under national law before the adoption of CSDR to continue operating under such national law until they have been authorised under the new CSDR rules (the "grandfathering clause").

Feedback received from respondents to the public consultation show that the authorisation procedure has been widely regarded as lengthy (sometimes up to 2 years, although broadly about 6 months from the date that the application is complete)[318] and burdensome by CSDs. As of 31 July 2021, out of 28 EEA CSDs that are subject to authorisation requirements under CSDR, two have not been authorised under CSDR, and still relying on the grandfathering clause.[319]

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

The experience in this respect shows that this exercise may be redundant from one year to the other, depending on the CSD at stake. The majority of key stakeholders (i.e. national competent authorities and CSDs) considered this exercise to be too burdensome to be carried out on an annual basis unless justified by the risk profile of the CSD. Thus, most respondents to the public consultation considered that the frequency of the annual review process should be amended in order to allow for more flexibility in this respect.

CSDR also sets organisational rules for CSDs including notably: governance, record keeping and outsourcing rules; conduct of business rules in the relations between CSDs and their users, including transparency requirements and communication procedures with participants; rules regarding the provision of services by CSDs in order to ensure the integrity of securities issues, protection of securities of participants and those of their clients, protection of the settlement finality and cash settlement and protection against a participant's default; and capital requirements and prudential requirements covering legal, general business, operational and investment risks.

Today, all these organisational rules have entered into force and are implemented by the key stakeholders, in particular the CSDs. These requirements did not raise concerns from key stakeholders in the answers to the public consultation. As regards the integrity of the issue, it should only be noted that in May 2020 T2S faced an operational incident which led to 1 835 securities positions and 22 cash balances ending up with negative balances[320]. This incident was solved within two days but raised some questions regarding the interpretation of some CSDR level 2 provisions regarding the suspension of

[318] https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en.
[319] ESMA data provided to the Commission.
[320] TARGET2-Securities Annual Report 2020 (europa.eu).

a securities issue from settlement until the problem is solved.

CSDR also introduced a regime for the provision of banking-type ancillary services by CSDs. By preference, and in order to avoid settlement risks due to the insolvency of the settlement agent, a CSD should settle, whenever practical and available, the cash leg of the securities transaction through accounts opened with a central bank. If this option is not practical and available, CSDR provides two other possibilities, both subject to conditions and requirements: to settle through accounts opened with a credit institution and to provide banking services ancillary to settlement directly.

CSDs offering settlement in commercial bank money as an ancillary service must comply with additional requirements to mitigate mainly credit and liquidity risks for the CSD and its participants,[321] e.g. CSDs have to be authorised as a credit institution under the applicable banking legislation and comply with the regulatory capital requirements set in the Capital Requirements Regulation. Today, only 5 out of the 28 CSDs in the EEA have applied to provide banking services under CSDR (of which 5 have been already authorised), and all of them provided these services pre-CSDR and no new providers have entered the market.[322]

CSDs offering settlement through a credit institution and above certain thresholds (i.e. the total value of cash settlement must be less than 1% of the total value of all securities transactions against cash settled in the books of the CSD and shall not exceed a maximum of EUR 2.5 billion per year) shall ensure that such credit institution is a limited-licence bank that provides services only to CSDs and that complies with additional requirements to mitigate the risks. However, no such designated credit institutions exists to date.[323] As such, CSDs cannot make use of this option to settle in commercial bank money.

CSDs settling in commercial bank money below the abovementioned thresholds do not have to comply with all the credit and liquidity requirements (i.e. they can use a normal commercial bank or can perform the services themselves).

From the public consultation and in contacts with stakeholders, it has become clear, that the settlement in commercial bank money in foreign currencies is limited and has not grown substantially since the introduction of CSDR. Although the safety of the settlement markets is an important objective, from the perspective of the objective to enhance cross-border transactions and the improvement of efficiency of settlement markets this is sub-optimal and the constraints appear disproportionate. First, designated credit institutions do not exist (yet). The fact that it can only service CSDs, thus have a very limited business role, is assumed to have prevented market players from establishing such an institution. Second, the thresholds under which CSDs can use a commercial bank to settle in commercial bank money are deemed too low by many stakeholders to develop foreign currency settlement services. As an example, for smaller CSDs with lower turnover ratio[324], e.g. 11, the current threshold of EUR 2.5 billion settlement per year

[321] Credit risk is the risk an institution faces when lending to borrowers that cannot meet their obligations. Liquidity risk refers to the inability of an institution to meet its own financial obligations.

[322] ESMA CSD Register (see note 26)

[323] ESMA Report 'Provision of banking-type ancillary services under CSDR' (see note 88).

[324] The asset turnover ratio measures the value of a company's sales or revenues relative to the value of its assets. The asset turnover ratio can be used as an indicator of the efficiency with which a company is using its assets to generate revenue. The higher the asset turnover ratio, the more efficient a company is at generating revenue from its assets. Conversely, if a company has a low asset turnover ratio, it indicates it is not efficiently using its assets to generate sales..

would be reached with issuance corresponding to EUR 229 million – less than half the size of a regular bond issue, leaving no possibility to offer issuance to others in the same or other currencies in commercial bank money. In a recent confidential survey, a majority of respondents indicated that an increase in the threshold in Article 54(5) would satisfy the CSDs' needs for the intended business of settlement in foreign currencies[325].

3. Requirements aimed at ensuring a level playing field for CSD services

CSDR includes provisions that aim to ensure a level playing field for CSD services both at EU and international level.

Within the EU, CSDR introduced two sets of rules in this respect: a passporting framework, already presented in paragraph 1 above; and a framework for supervisory cooperation.

Under a framework for supervisory cooperation, national competent authorities, relevant authorities and ESMA are required to cooperate closely and, on request and without undue delay, provide one another with the information required for the purposes of carrying out their duties.

With respect to the provision of services in other Member States, CSDR further provides that where a CSD has become of substantial importance for the functioning of the securities markets and the protection of the investors in more than one host Member State, the home Member State may decide that such cooperation arrangements are to include colleges of supervisors[326]. In practice however, only one college has been set up for an EU CSD[327].

It emerges from answers to the public consultation and various bilateral inputs from stakeholders that views are split on whether cooperation arrangements under CSDR work in an efficient manner. It should however be noted that the majority of respondents to the public consultation, including public authorities and banks, considered that the cooperation amongst NCAs would be improved if colleges were established and they were always involved in notably the passporting process[328].

Regarding third-country CSDs, Article 25(1) of CSDR provides that they may provide their services in the EU, including through setting up branches on the territory of the EU. Article 25(2) requires a third-country CSD to apply for recognition to ESMA in two specific cases: (a) where it intends to provide certain core CSD services (issuance and central maintenance services related to financial instruments governed by the law of a Member State); or (b) where it intends to provide its services in the EU through a branch set up in a Member State. Services other than those described (including settlement services) do not require recognition by ESMA under Article 25 CSDR. ESMA may recognise a third-country CSD that wishes to provide issuance and central maintenance services only where the conditions referred to in Article 25(4) of CSDR are met. One of those conditions is that the Commission has adopted an implementing act determining that the regulatory framework applicable to CSDs of that third country is equivalent in

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325 Based on confidential information provided to DG FISMA services.

326 Article 24(4) of CSDR

327 The Latvian supervisory authority established and led the Nasdaq CSD SE supervisory college in cooperation with supervisory authorities and central banks of Lithuania, Estonia and Latvia https://www.fktk.lv/en/news/press-releases/nasdaq-merges-its-baltic-csds-to-create-nasdaq-csd/.

328 Summary report of the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories 8 December 2020 – 2 February 2021, paragraph 3.3.3

accordance with CSDR. One CSD has applied to date for recognition to ESMA, i.e. the UK CSD in the context of Brexit. At least two other CSDs have contacted ESMA and have expressed their intention to apply for recognition as third-country CSDs.

However, according to the current provisions of Article 25 of CSDR, the recognition process is only triggered once there is an equivalence decision issued by the European Commission in respect of a particular third country. In the meantime, according to Article 69(4) of CSDR, third-country CSDs can continue providing services in the EU under the national regimes (the so-called "grandfathering clause"). As CSDR is now approaching its full entry into force (notably with the settlement discipline regime that should enter into force on 1 February 2022), concerns start to arise regarding such grandfathering clause. Some stakeholders, including national competent authorities and certain EU CSDs, supported the introduction of an end-date to the grandfathering arguing, amongst others, that currently third-country CSDs can continue to service EU securities even though they comply with rules which have not been determined as equivalent by the Commission. However, other stakeholders, mainly a couple of national competent authorities and third-country CSDs expressed their views against amending the current grandfathering framework, arguing that this would create legal and financial uncertainty for third-country CSDs if they are not recognised by the end of the grandfathering period, which would introduce unnecessary risk to the market.

Notwithstanding the above, a common observation is the lack of clear information on the exact services that third-country CSDs provide within the EU under the grandfathering clause[329].

Section 7 Answers to the evaluation questions

Question 1: How effective has the EU intervention been?

- To what extent have the objectives of CSDR to: (1) increase efficiency of the EU settlement market; (2) increase safety of the EU settlement market and (3) ensure level playing field for CSD services been achieved and what factors influenced the achievements observed?

1. Efficiency of the EU settlement market

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

In 2010, the European securities market was deemed very significant; according to ECB statistics[330], 690 million trades were executed on securities exchanges in the EU in 2010, representing a total value of over €33 trillion. The EU capital market was the second in

[329] https://ec.europa.eu/info/consultations/finance-2020-csdr-review_en
[330] http://sdw.ecb.europa.eu/reports.do?node=1000001584.

size after the US capital market and represents around 30% of the global market (the US represented around 35% of the total[331]).

In 2014, when CSDR was adopted, EUR 43.5 trillion worth of securities were held in EU securities settlement systems, which handled over 330 million delivery instructions for a total of turnover of over EUR 850 trillion.

At the end of 2019, there were over EUR 53 trillion worth of securities in EU Securities Settlement Systems handling over 420 million delivery instructions in 2019 for a total of turnover of over EUR 1 120 trillion[332]. This represents a growth of 22% in value of securities held, 27% in number of delivery instructions and 32% in turnover in the period between 2014 and 2019.

This also confirms the important role of CSDs serving the growing European Capital Markets.

Depite this overall growth of the EU settlement activity, an important consideration is that in the EU the three[333] largest CSDs hold over 60% of all securities held in EU CSDs. In the same period, the value of securities held by the UK CSD[334] rose from EUR 6 215 billion in 2015 to EUR 6 406 billion in 2019 (an increase of 3%), while the value of delivery instructions rose from EUR 272 087 billion to EUR 357 184 billion respectively (an increase of 31%)[335]. In the US[336], the value of securities held by the two CSDs[337] rose from EUR 100 739 billion in 2015 to EUR 130 366 billion in 2019 (an increase of 29%), the number of delivery instructions processed increased from 362 663 000 (2015) to 672 887 000 (2019) (an increase of 86%) for a value of EUR 355 trillion in 2015 to EUR 401 trillion in 2019 (an increase of 13%).

Depite this overall growth of the EU settlement activity, an important consideration is that in the EU the three[338] largest CSDs hold over 60% of all securities held in EU CSDs.

It can be concluded that EU settlement activity is concentrated in a few CSDs, albeit that the same applies to settlement activity in other comparable jurisdictions. In addition, there was generally increased settlement activity, explained by increased trading activity, that in turn can

Other signs point in the direction of a slow but surely moving in the direction of a real EU settlement market as well. First, mergers between clearing houses, CSDs, and stock exchanges have created EU financial market infrastructure conglomerates, such as the formation of Clearstream through the merger of Cedel International and Deutsche Boerse in 2012. With the acquisition of the Norwegian and Danish CSDs in 2019 and 2020

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331 According to the McKinsey "Global Capital Markets: Entering a New Era" September 2009 http://www.mckinsey.com/mgi/reports/pdfs/gcm_sixth_annual_report/gcm_sixth_annual_report_full_report.pdf

332 Data generated through the Securities Trading, Clearing and Settlement Statistics Database, European Central Bank. Accessed on 29 April 2021. Available at: https://sdw.ecb.europa.eu/browse.do?node=9691131

333 Euroclear Bank Belgium (28%), Clearstream Banking Frankfurt (18%), Clearstream Banking Luxembourg (15%).

334 Euroclear UK and Ireland.

335 "Securities trading, clearing and settlement statistics", European Central Bank, September 2020

336 Bank for International Settlement, Red Book Statistics, Payment and financial market infrastructures. Available at: https://stats.bis.org/statx/toc/CPMI.html. Accessed on 01 June 2021.

337 DTC and Fedwire Securities Service

338 Euroclear Bank Belgium (28%), Clearstream Banking Frankfurt (18%), Clearstream Banking Luxembourg (15%).

respectively, Euronext has also strengthened its presence in the EU settlement markets as well in the area of stock exchanges and clearing houses with the acquisition of Borsa Italiana, MTS, where most of Italy's sovereign debt is traded, as well as the major multi-asset clearing house, CC&G in 2020..

Economies of scope could also be obtained through horizontal synergies. In 2009 Euroclear brought the Belgian, Dutch and French domestic CSDs onto a single platform, under a harmonised framework, but as separate legal entities. Nasdaq has also consolidated the three Baltic CSDs (Estonia, Lithuania and Latvia) in 2017 and the Icelandic CSD into a single legal entity in 2020. As a result of these changes the nominally fragmented post-trade market in Europe is dominated by large conglomarates offering post-trade services, i.e. Euroclear (bringing together the international CSD Euroclear Bank and national CSDs in Belgium, Finland, France, Ireland, the Netherlands, Sweden and the United Kingdom), Euronext (bringing together national CSDs in Portugal, Denmark, Norway and Italy), Nasdaq CSD (following the merger of the regional CSDs for Lithuania, Latvia, Estonia and Iceland) and Deutsche Boerse Group (operating the ICSD Clearstream Luxembourg, the German CSD and LuxCSD).

Responses from the public consultation confirm these findings. Although most stakeholders, did not express an opinion as to whether CSDR has actually increased competition amongst CSDs, a group of stakeholders representing central banks, CSDs and their participants, as well as a CSD and a bank underlined that data on competition in the CSD market and the level of cross-CSD settlement does not provide evidence of a significant increase in competition or cross-border services or cross-CSD settlement. According to those stakeholders, reasons for the lack of evidence for increased competition between CSDs and the absence of significant cross-CSD settlement include: (a) diverging national practices in corporate actions processing and diverging national corporate laws or corporate governance rules; (b) diverging practices in withholding tax refund and relief at-source procedures; (c) diverging market practices in collateral management; (d) lack of harmonisation in issuance procedures. It was also noted that such national divergences also hinder mergers of CSDs.

There were also positive views on CSDR's impact on competition. In particular, it was noted that the harmonisation brought about by CSDR (which according to a bank enhanced, amongst other things, the transparency of CSD fees and introduced high standards for CSDs' operations) contributed to competition amongst EU CSDs. Some stakeholders noted that CSDR's impact on competition should not be analysed in isolation as many other factors, such as the launch of T2S and the related harmonisation efforts, impacted the CSD market in recent years.

Although various parrallel developments in the EU settlement market make the drawing of conlusions difficult, especially since the time frame for trends between the original CSDR entry into force and present is short, developments pointed out above point to a slowly but steadily forming EU settlement market but still largely focused around national markets, due to different, legal, corporate and tax rules that make the formation of single European wide CDS operators difficult to form.

CSDR also aimed at improving efficiency of the EU settlement market by increasing competition between CSDs through the introduction of the passporting regime. This objective has been at least partly achieved since most of the applying CSDs have been able to obtain a "passport" to offer notary and central maintenance services in one or several other Member States. However, the process itself has been significantly more burdensome than previously thought. The majority of CSDs considered that the passporting process has not prevented CSDs from offering issuer CSD services for securities constituted under the laws of another Member State as such, but has slowed down their ambitions. Certain CSDs noted that they had to withdraw some passport requests due to local constraints that are disputable, e.g. compliance with the direct individual segregation model applicable under national law.

Another important achievement of the CSDR is that settlement periods are reduced to T+2. The settlement period was harmonised in Europe and set at a maximum of two days after the trading day (T+2). A harmonised settlement period aims to reduce operational inefficiencies and risks for cross-border transactions, while reducing funding costs for investors (for instance, for those that have to deliver cash or securities at T+3 but can only receive them at T+2). Shorter settlement periods has an important advantage of reducing counterparty risk, that is, the period of time during which an investor runs a risk that its counterparty will default on its obligation to deliver cash or securities at the agreed settlement date.

Finally, CSDR also aimed to achieve efficiency of the EU settlement market by imposing a strict settlement discipline regime that would reduce settlement fails rates within the EU. Given that this framework has not yet entered into force it is difficult to assess what the exact impact on settlement efficiency would have. However, a large majority of the respondents to the public consultation, including public authorities, CSDs, CCPs, banks, asset management companies, market makers, and their respective associations, have raised already the fact that the settlement discipline framework should be reviewed. From those respondents, a vast majority indicated that the rules related to buy-ins should be reviewed, with a large majority (all categories of stakeholder included) in favour of voluntary buy-ins. Such respondents notably anticipate that the mandatory buy-in requirements as introduced in CSDR may reduce market liquidity, increase the costs for investors, creat unlevel playing field for EU CSDs and negatively impact securities lending and repo markets.[339] The reporting and penalty requirements of the settlement discipline regime have however raised much less comments from respondents.

In light of the above, we can conclude that CSDR has largely paved the way of a more efficient EU settlement market, notably by creating synergies and cross border opportunities for CSDs, and by reducing settlement period to T+2. However, CSDR may still be improved with a view to better achieve this objective, in particular by simplifying the passeporting process and enhancing supervisory cooperation between authorities with a view to facilitate the developement of cross-border activities. Furthermore, despite the fact that it has not yet entered into force, further thoughts should be put into the improvement of the settlement discipline regime, in particular the buy-in requirements.

2. Safety of the EU settlement market

Before the entry into force of CSDR, CSDs were subject to different authorisation and supervision regimes across the EU.[340] Differences can be broadly divided into three categories: (1) different definitions of CSD services, (2) different authorisation and supervision regimes and organisational rules, and (3) lack of a common prudential framework.

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[339] Summary report of the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories 8 December 2020 – 2 February 2021, paragraph 3.7.2.

[340] 2014 IA, p.14: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD%3A2012%3A0022%3AFIN

It was determined that definitions of CSDs and of the CSDs' services vary considerably, for instance in the different holding systems, with the three core functions not distinguished between each other nor with the ancillary functions. In the indirect holding systems the central safekeeping function was either incorporated into the notary function (France) or into the settlement function (the UK). Ancillary services were not uniformly defined or recognised, especially the banking services which could not be offered by CSDs in most Member States, while they form an integral part of the CSD functions in other Member States (Germany, Belgium).

These differences had consequences in terms of level playing field but also of safety: the lack of a common definition of core CSD services and of who can/cannot provide such services can lead to some of the core services, particularly settlement, being provided by institutions not authorised as CSDs causing an unlevel playing field as some parties could for example settle internally protected by the SFD, and others could not, or for instance between those who are allowed to provide banking-type of services and those who are not.

Risk to the soundness of CSDs, arose from the ability of some CSDs to engage in activities with higher risk, such as banking-type of activities, raising the risk profile of CSDs that undertake these activities, albeit mitigated to some extent by the limitation in scope of these activities (essentially to deposit taking and credit granting <u>related</u> to the CSD's core activities) and by strict CPSS-IOSCO requirements, including full collateralisation of credit.

In some Member States there was no specific authorisation regime for CSDs but their functions were regulated by various national regulations. In most direct holding countries CSDs are designated by law to perform some core and ancillary functions such as registrar and account providing (safekeeping) functions and the other functions are derived from these. In other countries CSDs are deemed to have a banking status. These differences led to the fragmentation of the EU post trading market described. This fragmentation resulted in the cross-border settlement of transactions relying on a "spaghetti" model of links between CSDs and/or a chain of intermediaries. This has obvious consequences for the safety and efficiency of cross-border transactions.

Before CSDR, organisational and conduct of business requirements, rules regarding the integrity of the issue and rules regarding the provision of banking services ancillary to settlement, diverged from one Member State to the other, with some CSDs being subject to less stringent requirements than others. Harmonisation of such requirement from the above in CSDR aimed at strengthning CSDs organisation and rebalancing the relationship between CSDs and participants.

Finally, European CSDs also lacked a common prudential framework. They were subject to technical standards by ECB and to recommendations by CPSS-IOSCO and ESCB-CESR. However, due to their soft law nature, these standards and recommendations are implemented in different ways. This raised several problems: possible failures due to non regulated operational or financial risks would have tremendous consequences for a national market as it would essentially block the securities market, with severe implications for the ability of market participants to honour their obligations, the lack of a common prudential framework could lead to regulatory arbitrage favouring the CSD with the "softest" approach and as the markets are becoming more integrated, link arrangements between CSDs are expected to increase, especially in the post-T2S environment possibly creating additional legal, credit, liquidity and operational risks arising from differences between the laws of the linked CSDs concerning netting, finality of transfers, ownership and collateral owing to inefficiencies associated with the operation of the link, such as variations in the settlement cycles and settlement discipline of the linked systems and for example in the case one CSD permits provisional transfers of funds or securities that may be unwound.

Prudential requirements are also about ensuring the CSDs have reconciliation rules of their records in order to prevent the unauthorised creation or deletion of securities. There are also rules that prohibit artificial creation of securities, provisional transfers of securities across CSD links and re-use of securities without client consent, or rules that require CSDs to segregate participants' securities from their own assets and to support the segregation of securities belonging to a participant's customers on the participant's books.

In light of the above, we can conclude that CSDR has generally achieved the objective of improving safety of the EU settlement market, at the risk of being sometimes too stringent. Indeed, although the majority of CSDs that responded to the public consultation consider that the conditions set out in CSDR for the provision of banking-type ancillary services by CSDs are proportionate, some CSDs noted that such requirements may not be proportionate to the risks and volumes of certain banking services they intend to provide, especially in the case of smaller CSDs. It can be noted in this respect that all of the 5 CSDs that have applied to provide banking services under CSDR already provided these services pre-CSDR and no new providers have entered the market. Furthermore, none of the CSDs providing services do so through designated credit insitutitions as allowed by CSDR, for the simple reason that no credit institution offer such services for the moment (respondent to the consultation mentionning notably that the limited activity and the limited number of potential transactions due to CSDR restrictions mean that such kind of credit institutions would not be economically viable).

3. **Level playing field for CSDs**

Before the entry into force of CSDR, cooperation between national competent authorities regarding the supervision of EU CSDs was ensured on a bilateral basis only, between the authorities, without: i) any strict requirement applying in this respect; ii) a minimum common set of organisational and prudential requirements applicable to CSDs; and iii) the involvment of ESMA. Such situation created the risk of an unlevel playing field between EU CSDs operating in a Member State, those established locally being subject to local requirements whilst those operating on a cross border basis were subject to a different set of requirements, not necessarily always completely aligned.

By creating an harmonized set of requirements applying to CSDs and introducing cooperation requirements between national competent authorities, CSDR moved substantially closer to its objective to ensure a level playing field for CSDs within the EU. However, evidence from the targeted consultation and bilateral information provided by stakeholders shows that views are split on whether cooperation arrangements under CSDR work in the most efficient manner. For example, despite the fact that CSDR provides the possibility for national competent authorities to set up colleges, no such college has yet been put in place for EU CSDs. It should be noted that the majority of respondents to the targeted consultation, including public authorities and banks, considered that the cooperation amongst national competent authorities would be improved if colleges were established and, in particular, they were always involved in the passporting process notably.[341]

On an international level, CSDR aimed at ensuring the EU alignment with the global standards applying to the settlement environment, in particular the Principle for Financial Markets Infrastructures (PFMIs) adopted by the Bank of International Settlements (BIS) and the International Organisation of Securities Commissions (IOSCO) in April 2012.[342] This aimed at ensuring international consistency in the framework under which CSDs operate. Nevertheless, in some aspects the requirements set out in CSDR go beyond the PFMIs, e.g. this is the case for settlement discipline regime, which includes the buy-in regime that is not part of the PFMIs and rarely implemented in other jurisdictions[343], e.g. the UK announced it is not implementing the CSDR Settlement Discipline Regime[344].

The impact of the discrepancies between the rules applicable to EU CSDs and those applicable to non-EU CSDs could be attenuated if non-EU CSDs were authorised to provide core services within the EU only further to an equivalence and recognition process. However, the existence of a grandfathering clause in CSDR, allowing non-EU CSDs to continue providing services in the EU under the national regimes until an equivalence decision is issued by the Commission creates a de facto situation where third-country CSDs may keep serving EU participants under a legal framework different (and potentially less stringent) to the one applicable to EU CSDs. Without any end-date to the grandfathering clause and absent the possibility for the Commission to issue negative equivalence decisions, such situation could continue - potentially indefinately.

Question 2: How efficient has the EU intervention been?

- To what extent have CSDR's core requirements on settlement discipline, organisational, conduct of business and prudential requirements for CSDs, the passport system, increased prudential and supervisory requirements and increased cooperation requirements given the effects they have achieved in promoting an EU settlement market and in mitigating systemic risk?

Since not all of the requirements of CSDR have entered into application, such as the requirements of settlement fails part of the settlement discipline rules, and CSDR's limited history of application overall make definitive conclusions on settlement efficiency difficult, the following can be mentioned.

In broad terms, CSDR is achieving its original objectives to enhance the efficiency of settlement in the EU and the soundness of Central Securities Depositories ('CSDs'). For

341 Summary report of the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories 8 December 2020 – 2 February 2021, paragraph 3.3.3.

342 Principles for financial market infrastructures, Issued by the Committee on Payments and Market Infrastructure (CPMI) of the Bank of International Settlements (BIS) and the International Organization of Securities Commissions (IOSCO) in April 2012.

343 During the CSDR public consultation stakeholders referred to a few arrangements similar to the CSDR settlement discipline regime. For instance, in the USA, the SHO Regulation and SEC Rule 204, relates only to short-selling and the obligation that broker and dealer must close-out unresolved equities transactions. Examples of buy-ins were given for Asian markets, e.g. Singapore Exchange where any unsettled buy-in trade is carried forward to the next business day for settlement. If the buy-in and procurement remains unsuccessful by ISD +6, cash settlement will be initiated against the seller to provide resolution of the sale trade. However the Singapore Exchange has a very low failure rate because of DvP and very few trades go to buy-in.

344 Written statement by Chancellor of the Exchequer on 23 June 2020. See: https://questions-statements.parliament.uk/written-statements/detail/2020-06-23/HCWS309.

most areas, significant changes to CSDR would be premature considering the relatively recent application of requirements.

One of the main objectives of CSDR was to reduce the complexity of and facilitate cross-border settlement in order to limit the risk and cost involved in such operations. The ongoing inefficiencies in the EU settlement market are due to a burdensome passporting process, insufficient cooperation between authorities CSDR has not proved efficient at faciliating cross-border settlement. Passporting requirements remain burdensome, there is insufficient coordination among the various authorities responsible, while requirements for the provision of banking services remain restrictive. CSDR requires the establishment of cooperative arrangements between home and host authorities when certain conditions are met and even allows for the voluntary establishment of colleges of supervisors, in practice such arrangements have barely been used. Compliance costs with CSDR requirements have so far proved disproprotionate, both for market participants and regulators. Legal requirements remain unclear requiring regulators to provide guidance to CSDs and other market participants. Compliance costs are thus considered excessively burdensome or the costs outweigh the potential benefits of the regime.

As a result the competition amongst providers of CSD services remains limited and the costs incurred by investors in cross-border transaction remain high. CSDR has thus proved so far inefficient in creating an integrated EU market for settlement services.

In certain areas of CSDR, requirements evaluated indicate that certain enhancements can be made. For instance:

- Passporting. Responses from stakeholders in the public consultation indicate that costs for obtaining passports in the different Member States was costly and burdensome and from an individual confidential response the Commission has received an estimation on the costs of passporting to a few countries, and together with legal costs understand that these costs run into the millions of Euro.
- Supervision. From supervisors, the Commission received input to the effect that supervision can be quite burdensome and as an example the annual assessments of CSDs are quite resource costly and that in some cases these costs could be attributed to the industry. In addition, authorisation is mentioned as costly, although it can be said that these are one-off costs and that most authorisations have been finalized. On the other hand, these costs could hamper new entrants into the market.

Question 3: How relevant is the EU intervention?

- To what extent are CSDR's requirements on settlement discipline, organisational, conduct of business and prudential requirements for CSDs, the passport system, increased prudential and supervisory requirements and increased cooperation requirements still relevant to promote an EU settlement market and the stability of the financial markets and in light of current developments in this market?

CSDR originated from the call of the FSB in 2010 for more robust core market infrastructures and asked for the revision of the and enhancement of existing standards. In April 2012, the Committee on Payments and Settlement Systems (CPSS) of the Bank of International Settlements (BIS) and the International Organisation of Securities Commissions (IOSCO) adopted global standards for financial market infrastructures. Taking into account the global nature of financial markets and the systemic importance of CSDs, it was deemed necessary to ensure international convergence of the requirements to which they are subject.

Since entry into force of CSDR in September 2014, the markets in settlement have increased significantly, both in terms of numbers of instructions as well in terms of total volume. Although there have been few new entrants in the market, consolidation within the EU of settlement providers have been taken place, adding evidence that competition benefits from CSDR although not for the smaller players. In addition, due to their essential role in the facitating of transparent, legally sound and efficient securities trading, attention of regulatory authorities have also focused on this part of the essential infrastructure of the financial markets. In the EU, for instance, initiatives are being developed to make CSD more operational resilient and make these infrastructure morefuture proof in terms of innovative technologies, such as blockchain. In this context, 7 years after the entry into force of CSDR, its objectives to contribute to safe settlement markets, efficient settlement markets and increased cross border transactions remain valid. As discussed above, the initial results of evaluating the core requirements of CSDR show that CSDR is broadly achieving its objectives with in certain areas there could be enhancements in terms of optimizing the requirements to achieve the objectives in a more effective and efficient manner.

This is also confirmed by the EU's Capital Markets Union action plan[345] to make its financial markets deeper and more liquid with, as a corner stone in those plans, developing more integrated and more efficient financial infrastructures in the area of post-trade. In addition, as stated in the Commission's Communication on open strategic autonomy[346] for the financial structure, post-trade has a role, to develop these infrastructure into strong international competitive players and boost European strategic autonomy.

Question 4: How coherent is the EU intervention?

-To what extent are CSDR's requirements on settlement discipline, organisational, conduct of business and prudential requirements for CSDs, the passport system, increased prudential and supervisory requirements and increased cooperation requirements coherent with other pieces of EU financial legislation.

CSDR brought harmonized requirements for central securities depositories. These requirements were introduced after the Financial Stability Board, on 20 October 2010,called for more robust core market infrastructures and asked for the revision and enhancement of the existing standards. In April 2012, the Committee on Payments and Settlement Systems (CPSS) of the Bank of International Settlements (BIS) and the International Organisation of Securities Commissions (IOSCO) adopted global standards for financial market infrastructures. Taking into account the global nature of financial markets and the systemic importance of CSDs, it was deemed necessary to ensure international convergence of the requirements to which they are subject.

CSDR is also broadly in line with the EU's core pillar of creating and boosting the Internal Market and the freedom to provide services: the creation of an integrated market for securities settlement with no distinction between national and cross-border securities transactions is needed for the proper functioning of this internal market. For example, the freedom to provide services is apparent in the passporting but also third-country parts of

345 https://eur-lex.europa.eu/resource.html?uri=cellar:61042990-fe46-11ea-b44f-01aa75ed71a1.0001.02/DOC_1&format=PDF

346 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021DC0032&from=EN

CSDR; CSDs should benefit from a clear and as less burdensome access as possible and deemed necessary.

Other relevant existing EU regulations that have an interplay with the CSDR are:

- The banking regulations, Capital Requirements Regulation[347] and Directive[348]. Prudential and other requirements are either directly, in the case of banking CSDs, or indirectly, in the case of non-banking CSDs, applicable to CSDR actors.
- Securities' markets legislations, such as Settlement Finality Directive[349], Financial Collateral Directive[350] as well as MIFID[351] and EMIR[352].

In addition, CSDR requirements are in line with initiatives currently undertaken by the EU. First, the Commission's Capital Market Union Action Plan[353], striving for deeper and more liquid financial markets in the EU and of which a core element is the development of post – trading infrastructures, amongst which CSDs are a constituting part. Second, post trading infrastructures are strategic nodes in the financial system and could play a part in the strategy of the EU to strenghten its stategic autonomy. As CSDs serve as gateways to foreign financial markets and their openness benefits EU businesses and investors, their soundness and relevance will also help to boost the role of the EU on the world stage. Strengthening market infrastructures' operational resilience includes shielding the sector from increasingly pervasive, targeted and impactful cybersecurity threats and vulnerabilities. A number of EU-based financial market infrastructures provide global depository and messaging services. Their international operations make them vulnerable to disruptive actions by third countries. It is important for the EU to preserve the global reach of these infrastructures, while safeguarding the open strategic autonomy of the EU. Third, CSDR is in line with current initiatives in the area of digital innovation: the Commission's proposal to introduce a pilot regime for technological

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347 Regulation (EU) No 575/2013 (see note 157).

348 Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L0878&from=EN

349 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems: https://eur-lex.europa.eu/eli/dir/1998/26/oj/eng

350 Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements: https://eur-lex.europa.eu/eli/dir/2002/47/oj

351 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast): https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02014L0065-20160701

352 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02012R0648-20210628

353 https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/capital-markets-union-2020-action-plan_en#:~:text=On%2024%20September%202020%20the%20Commission%20adopted%20a,and%20companies%2C%20regardless%20of%20where%20they%20are%20located.

innovations[354] of CSDs and the initiative to enhance operational resilience of financial markets participants (DORA)[355].

Where CSDR is broadly coherent with the aformentioned legislations in terms of conduct of business rules, organisational and prudential rules, 2 areas were coherence is limited are the folowing:

- Third-country regime: in most EU legislation in the financial sector, third-country regimes consist of an equivalence framework including a notification requirement for recognition, also for existing third-country providers within the EU. CSDR has grandfathered existing providers without an end-date.
- Passporting: in most EU legislation in the financial sector, passporting consists of a mere notfication to the host Member State, in CSDR passporting effectively means an authorization process by the host Member State as the passporting process is not standardized as such and Article 49(1) could lead to relevant national authorities to examine if a CSD complies with the host commercial and civil laws before entering the market.

Question 5: What is the EU-added value of the intervention?

To what extent have CSDR's requirements on settlement discipline, organisational, conduct of business and prudential requirements for CSDs, the passport system, increased prudential and supervisory requirements and increased cooperation requirements helped increasing safety of cross-border transactions, increasing efficiency of cross-border transactions; ensuring level playing field for CSD services and to what extent do the risks relating to the markets continue to require action at EU level?

CSDR is the first EU-wide regulation on Central Securities Depositories which, since 2014, introduced a uniform approach for the EU settlement markets. It introduced a framework aiming for efficient settlement markets, increased cross-border transactions and a level playing field CSDs for relevant stakeholders on the EU capital markets.

As the EU markets for settlement is, by its very nature, an interconnected and international market, the EU level requirements by a directly applicable Regulation contributed to a level playing field for competition in the area of settlement, increased cross-border transactions as well as increasing safety of these markets. Although not all requirements have entered into application, such as the majority of settlement discipline requirements, the following can be mentioned on the added value of of EU action on settlements.

First, after the entry into force of CSDR, markets have become less fragmented along national lines. CSDR contributed to aligning rules across the whole of the EU and the EEA. Requirements on banking services brought the same rules across the EU with respect to prudential rules but also similar treatment of credit and liquidity risks and on how banking services should be authorised and supervised. Passporting requirements

[354] COM(2020) 594 final, 2020/0267 (COD), Proposal for a of the European Parliament and of the Council on a pilot regime for market infrastructures based on distributed ledger technology: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=COM:2020:594:FIN

[355] Proposal for a Regulation of the European Parliament and of the Council on digital operational resilience for the financial sector (DORA) and amending Regulations (EC) No 1060/2009, (EU) No 648/2012, (EU) No 600/2014 and (EU) No 909/2014.

brought increased opportunities to offer services across intra EU-borders and third–country requirements brought certainty for those CSDs offering their services within the EU.

Second, this consistency has increased the safety of EU settlement markets as supervision has become more intertwined and benefitting from more coordination and actions aimed at supervisory convergence by the European Securities Markets Authority. This has led to more consistent rules but also more coordination of the application of the rules by bringing guidance to supervisors on how to apply certain rules. Enhanced data improved the position of supervisors and enabled to also compare across border.

Although CSDR requirements have helped to mitigate risks on the European market, led to more cross-border transactions as demonstrated by increased cooperation between market players as well as the overall increase in the market in terms of size and number of settlement instructions, feedback from the public consultation as well as the wider feedback process, seems to indicate that requirements are sub-optimal and could be recalibrated in the areas mentioned above.

This supports the added value of the EU action via CSDR. Current initiatives such as the Commission's Capital Markets Union action plan[356] efforts to create more integrated post-trade infrastructures within the EU also support the future EU value–added.

Section 8 Conclusions

The objectives of CSDR to increase the safety and efficiency of EU settlement market and ensuring a level playing field for CSD services **remain relevant**, and associated risks with EU settlement markets persist.

While not all of the key CSDR requirements have entered into application, such as the measures to address settlement fails, the analysis shows that, based on the evidence available, the initial results of CSDR are delivering on the general objective to promote a more level playing field, increase safety and promote an efficient EU settlement market. The impact of the settlement fails measures have not been measurable as they have not been in place on the date of writing of this evaluation.

On the **effectiveness and efficiency** of the core requirements of CSDR, the evaluation indicates that while the volume of settled trades increased since the entry into force of CSDR, cross-border transactions remained stable and feedback from stakeholders indicate that in several areas, such as passporting, licensing, and supervisory assessments, significant barriers exist and preliminary findings suggest that actions **(i) to reduce disproportionate compliance burdens, (ii) to improve cross-border activity could be undertaken.** Improvements could be sought in the area of banking services, where the access to banking type ancillary services is limited which in turn inhibits settlement in foreign currencies and in improvement of supervision, both impacting the possibilities or opportunities for firms to offer services cross-border.

356 https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/capital-markets-union-2020-action-plan_en#:~:text=On%2024%20September%202020%20the%20Commission%20adopted%20a,and%20companies%2C%20regardless%20of%20where%20they%20are%20located.

The objectives of CSDR to increase the safety and efficiency of EU settlement market and ensuring a level playing field for CSD services **remain relevant**, and associated risks with EU settlement markets persist.

In terms of **coherence**, CSDR is aligned with international efforts to ensure stability and safety of post trade infrastructures. In addition, CSDR is coherent with other pieces of EU legislation, such as the Commission's Capital Market Union Action Plan, the Commission's proposal to introduce a pilot regime for technological innovations of CSDs and DORA.

In terms of the **EU added value**, CSDR covered a gap that existed in legislation by introducing a new framework aiming to address, in a uniform process at EU level, the lack of a harmonised approach towards the EU's settlement markets and in addressing the related systemic risks.

ANNEX 6: DETAILED DESCRIPTION OF IDENTIFIED PROBLEM AREAS

1. Barriers to cross-border settlement

One of the main objectives of CSDR was to facilitate cross-border settlement in order to limit the risk and cost involved in such operations. Nevertheless, seven years after CSDR's adoption, most stakeholders see limited progress in the provision of cross-border services by CSDs (see point (c) in Section 1.3.3).[357] The evaluation,[358] has identified three main reasons for this: burdensome passporting process; insufficient cooperation between authorities; and restrictive requirements for the provision of banking services related to settlement.

First, the **passporting process** (i.e. the special procedure under which a CSD authorised in a Member State can provide services in relation to financial instruments constituted under the law of another Member State), is **burdensome** as it requires, where relevant, the agreement of the host Member State authority, regarding the assessment by the CSD of the measure that it intends to take to allow its users to comply with the national law referred to in Article 49(1). All CSDs and their association responding to the Commission targeted consultation as well as some public authorities, noted difficulties in the process of obtaining the CSDR passport in one or several Member States.[359] Although the initial intention was to ensure that the provision of cross-border services by a CSD would not be used as a way for issuers, investors or third parties to circumvent applicable national laws, it made the passporting process burdensome. The additional burden deters CSDs from expanding their activities across borders (see sections 1.3.3, 2.2.1 and 2.3.1). This is in contrast to other areas of EU financial services legislation where minimal additional input is required by host Member State authorities to provide services cross-border.

15 CSDs have obtained or applied for a passport in at least one host Member State (see Annex 8, Figure I),[360] with nine of them being of substantial importance[361] to Member States (including EEA countries) other than that of their authorisation.[362]

One CSD noted that it stopped providing cross-border services to avoid the procedure while another stated that it is easier to provide services for securities constituted under third-country law than the law of a Member State.[363] Furthermore, some third-country CSDs may provide their services in relation to financial instruments constituted under the

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[357] ESMA Report on cross-border services (see note 50), p. 20.

[358] See "Annex 6 – Evaluation" and ESMA Report 'Provision of banking-type ancillary services under CSDR' (see note 88).

[359] Summary report of the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories ('Summary report of the CSDR targeted consultation') , https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2020-csdr-review-summary-of-responses_en.pdf .

[360] ESMA CSD Register (see note 26).

[361] Commission Delegated Regulation (EU) 2017/389 (see note 58), specifies the criteria to be considered in order to determine whether a CSD is of substantial importance for the functioning of the securities markets and the protection of investors in the host Member States concerned.

[362] Two CSDs are of substantial importance to one host Member State; three CSDs are of substantial importance to three host Member States; one CSD in six host Member States; one ICSD is of substantial importance in 19 host Member States and the other in 23 host Member States

[363] Summary Report of the Commission CSDR targeted consultation (see note 92).

law of a Member State without complying with the passporting requirements that apply to EU CSDs (see section 2.3.5). **This means that, in some cases, it is easier for those CSDs to operate cross-border in the EU than for an EU CSD**.

Second, the evaluation and stakeholder feedback has shown that **cooperation between authorities in home and host Member States and supervisory convergence is insufficient**, creating further obstacles in the CSDs' cross-border operations, hindering the creation of a true single market for settlement (see section 2.3.2), a conclusion that High Level Forum on the CMU also reached.[364] While CSDR requires the establishment of cooperative arrangements between home and host authorities when certain conditions are met and allows for the voluntary establishment of colleges of supervisors, **in practice there is no evidence that such arrangements have been used**. For example, while six CSDs are of substantial importance to more than one host Member States, **only one college of supervisors has been set up** under Article 24(3) of CSDR[365] and **no information is available to ESMA on whether the other required cooperative arrangements under CSDR have been set up**. This means that communication between authorities in different Member States is not standardised; the same CSD is likely to be subject to different supervisory arrangements and requirements in the different Member States in which it may operate. This is further exacerbated by the fact that no single authority participates in any arrangements that may have been set up to ensure that they all follow in practice the same supervisory approach (see also section 2.3.2).

Third, CSDR contains **strict conditions for CSDs to settle a transaction in commercial bank money** (see section 2.3.3). A securities trade typically results in an obligation for the seller to deliver securities (securities leg) and a corresponding obligation for the buyer to deliver cash (cash leg). To ensure delivery of the cash, a CSD may use accounts at a central bank[366] or commercial bank money (i.e. CSDs may open accounts in their own books or in a commercial bank). Access to central banks depends on the respective central bank, brings cost and therefore requires certain economies of scale. Consequently, settlement in commercial bank money is sometimes the only option available for CSDs that want to settle in currencies other than that of the jurisdiction in which they are authorised (e.g. because the CSD does not have an account with the central bank of the transaction's currency). However the restrictive nature of the conditions (low threshold, no designated credit institutions, lack of economies of scale to recuperate costs for banking license) under which this is possible means that CSDs refrain from **any cross-border activity.**[367] As a result, the **percentage of EEA CSDs' settlement activity in foreign currencies remains small** (Figure II), while the level of settlement in foreign currencies remains very limited; **only five to seven CSDs between 2016 and 2020 settling more than 10% of the transactions in foreign currencies**.

Furthermore, as seen in Figure III, **only four CSDs use more than four foreign currencies** in their settlement activity (one uses 10 foreign currencies; three use between

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[364] Final report of the High Level Forum on the Capital Markets Union (see note 70), p. 16.

[365] The Latvian supervisory authority established and led the Nasdaq CSD SE supervisory college in cooperation with supervisory authorities and central banks of Lithuania, Estonia and Latvia https://www.fktk.lv/en/news/press-releases/nasdaq-merges-its-baltic-csds-to-create-nasdaq-csd/.

[366] CSDR, in line with international standards, gives preference to settlement in central bank money as a credit balance at a central bank implies no credit risk since what defines a central bank is its absolute ability to issue currency to meet its needs. CSDs in the EU in principle have access to the central bank of the currency in their jurisdiction and can therefore settle trades in that currency in central bank money.

[367] As central banks can set their own access criteria, such as an obligation to be established in the jurisdiction of the relevant currency, this is even more pertinent for EEA CSDs considering activities outside the EEA.

25 and 33 currencies).[368] The other CSDs settling in foreign currencies use between one and two foreign currencies.[369] This means that issuers have a **limited choice for multicurrency issuance** which prevents genuine cross-border competition on all currencies (especially since issuers seek one-stop-shop solutions).[370]

Figure II: Settlement in foreign currencies by EEA CSDs

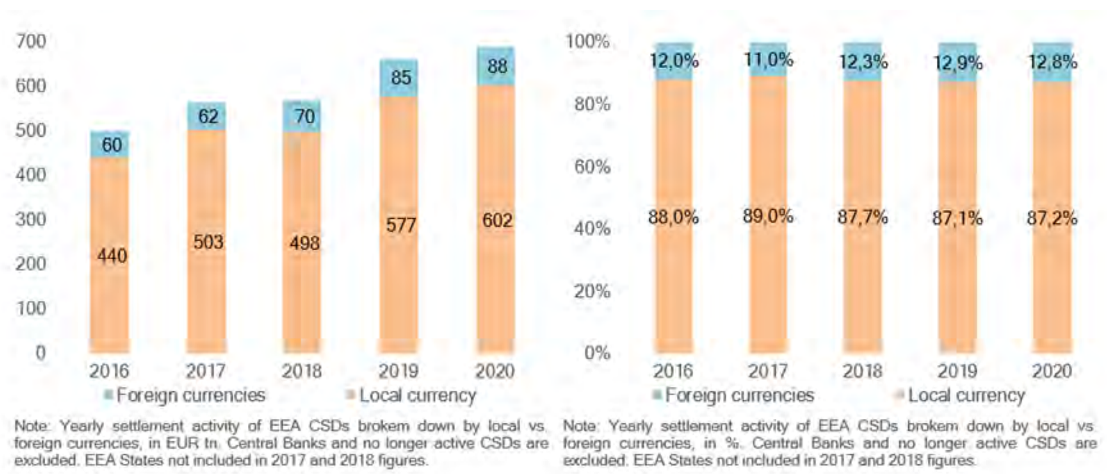
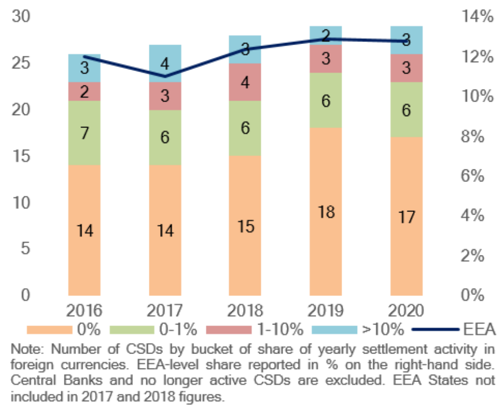


Figure III: Number of CSDs per range of yearly settlement in foreign currencies[371]



2. *Disproportionate compliance costs*

CSDR introduced new requirements for CSDs to safeguard the essential role they play in financing the economy and channelling investments. **Nevertheless, market participants and authorities have identified targeted areas where the compliance costs are**

[368] ESMA Report 'Provision of banking-type ancillary services under CSDR' (see note 88).
[369] Ibid.
[370] Euronext response to the Commission targeted consultation on CSDR: https://www.euronext.com/it/regulation/government-affairs.
[371] Report to the European Commission: provision of banking-type ancillary services under CSDR, ESMA, 8 July 2021: esma70-156-4582_report_to_the_ec_-_csdr_banking_services.pdf (europa.eu)

disproportionate, because (a) legal requirements are unclear, and/or (b) they are considered excessively burdensome, and/or (c) the costs of complying with the rules appear to outweigh the potential benefits.

Three areas have been identified as generating disproportionate compliance costs: passporting rules; rules on the provision of banking services related to settlement; and the settlement discipline regime.

First, the CSDR passporting rules allow CSDs to provide services for financial instruments constituted under the law of any Members State and not just that of their authorisation. In this way, **CSDs can benefit from access to a larger market** and issuers have more choice in where they issue and hold their securities. While the aim was to ensure the functioning of the EU single market, **the legal requirements have turned out to be unclear in practice and burdensome** (see section 2.3.1). For example, CSDs wishing to provide their services across the EU would need the agreement of 26 Member State authorities, in addition to their home authority, to do so. One CSD reported that 10-15 pages of application were needed for each EU jurisdiction that a passport was requested; this needed a further ca. 25-60 pages of external legal advice annexed per jurisdiction.[372]

The following examples shed light on burdensome and unclear passporting requirements:

First, **the concept "securities constituted under the law of a Member State"**[373] gives rise to interpretation. Article 23(2) of CSDR refers to "*the law of another Member State referred to in Article 49(1) [of CSDR]*", the latter provision mentioning the "*corporate or similar law of the Member State under which the securities are constituted*". This could be understood as referring to the 'governing law' (i.e. the law governing the issuance) or/and to the 'issuer law' (i.e. the law where the issuer is headquartered). This issue is often encountered for debt securities as for shares the governing and issuer laws are usually the same. According to a Q&A on this issue the 'law under which the securities are constituted' in the meaning of Article 49(1) of CSDR should be by default the 'standard' law of the issuance for each type of financial instrument per host Member State (i.e. for shares, the national law of the issuer, and for bonds, the law that has been contractually chosen to govern the issuance). However, several specific situations exist which are detailed in the Q&As. For example, under the current provisions of CSDR, the case may arise where a CSD would need to require passports in two separate Member States for a single issuance. This situation is considered in Q&A 9 of ESMA.[374] Article 23 of CSDR provides that CSDs should assess the measures to be taken to allow its users to comply with the national law referred to in Article 49(1). However, in the case of bonds, this could actually refer to the laws of two different Member States: the law of the issuer Member State and the law contractually elected for the bond issuance.

It should also be noted that – contrary to the Regulation– **Q&As are not legally binding** and therefore **stakeholders may claim that they are entitled not follow them** as, in their view, they are complying with the Regulation itself even if they are not complying with the Q&A. Only a change to the EU legislation clarifying a legal requirement would be legally binding.

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[372] Based on confidential information provided to DG FISMA services.

[373] Article 23(2) and Article 49(1) of CSDR.

[374] CSDR Q&As, ESMA70-156-4448, 31 March 2021, https://www.esma.europa.eu/sites/default/files/library/esma70-708036281-2_csdr_qas_2.pdf

In their answer to the targeted consultation,[375] multiple stakeholders raised the issue of the lack of clarity of Article 23(2) of CSDR. The time required for CSDs to identify the law to be considered as the "law under which securities are constituted" is burdensome. In addition, the lack of legal clarity as to which law should be considered creates uncertainty as to whether a passporting process has to be launched, and which national authorities should be involved in it.

Second, a question was raised as to whether the **CSDR passporting procedure applied to all types of securities**. A Q&A[376] clarified that Article 23 applies to all financial instruments.[377] However, this broad scope creates more barriers for CSDs to operate cross-border. For instance, according to a stakeholder the initial intention of the policy-makers was for the passporting requirement to cover equities only; the broad scope has resulted in an artificial barrier for issuance of bonds that already benefitted from the freedom of issuance prior to the CSDR.[378] Another underlined that the determination of the relevant host Member State is easier for shares than for bonds as for the latter different laws can apply such as the law of the issuer (for corporate aspects) or the law (s) contractually chosen to govern some (economic) rights. In addition, it noted that bond markets are very dynamic and the complexities of the passporting regime are particularly problematic for the issuance of bonds since they harm CSDs' ability to attract bond issuance from abroad.[379]

Third, Article 23(3)(e) of CSDR requires CSDs to include in the information they communicate to their competent authority, "**where relevant, an assessment of the measures the CSDs intends to take to allow its users to comply with the national law referred to in Article 49(1)**". The use of "where relevant" does not allow for a harmonised approach.[380] ESMA has clarified through a Q&A that "relevant" means "*whenever there are requirements under the national law that it has determined as being relevant for the users of each cross-border service it provides or intends to provide*".[381] It is therefore left to the CSDs to make their due diligence in that respect, **increasing the burden imposed on them**.

Fourth, the passporting process is lengthy. The average time required between receipt of the application and its transmission to host Member State authorities is six months.[382] The length of the review by the host Member State authority for applications reported as "approved" was on average 4 months.[383] It could be a lengthy and burdensome procedure before the CSD obtains the authorisation to provide its services in the host Member State. CSDs wishing to provide their services in multiple Member States have to repeat the process for each Member State separately. The lengthy process means that the issuer will either have to put on hold its projects during this period[384] or seek another provider, where alternatives exist. Ten-months on average per passport process may be particularly long for short-term instruments, especially in situations where the CSDs would like to

[375] Summary Report of the Commission CSDR targeted consultation (see note 92).
[376] CSDR Q&As (see note 164)
[377] Financial instruments are defined in point (15) of Article 4(1) of Directive 2014/65/EU (see note 2).
[378] ESCDA response to the Commission CSDR targeted consultation, https://ecsda.eu/archives/13474.
[379] Euronext response to the Commission CSDR targeted consultation (see note 106).
[380] ESMA Report on cross-border services (see note 50), par. 102.
[381] CSDR Q&As (see note 164), question 9(f).
[382] ESMA Report on cross-border services (see note 50), para. 68.
[383] Ibid, par. 72.
[384] Based on confidential information provided to DG FISMA services.

passport its services in multiple jurisdictions. This limits the incentive to request a passport and engage in cross-border business, limiting competition.

Fifth, **the passporting process is not standardised,** as confirmed amongst others by ESMA.[385] This has led to divergences **in the way different national authorities handle passporting applications**, e.g. the level of detail requested on the measures CSDs take to allow their users to comply with the national laws of the host Member State. For instance, it was reported that the legal opinion (which can have a significant impact on the passporting costs) and which is considered as mandatory by an ESMA Q&A, is only accepted by certain national authorities (but not by others) if issued as "external assessment".[386] Other examples include the need for additional supervision by the host authority on top of that of the home authority and the need for the foreign CSD to comply with certain domestic laws.

Sixth, **the role of the host national authority** is unclear, e.g. on whether it can request additional information and/or what is its role in the assessment of the measures the CSD intends to take to allow its users to comply with national law.[387]

The complexity of the passporting procedure and the difficulties in obtaining a passport, have been highlighted both by CSDs and their association as well as some public authorities.[388] One CSD stated that "[it] *is our assessment that despite the passporting regime introduced by CSDR, cross-border activity, namely the possibility for CSDs to offer services as Issuer CSDs for instruments issued under the law of another Member State has not sufficiently increased. Overall, the passport process has regrettably been significantly more burdensome than what was intended by the legislator*".[389]

In addition, the lack of clarity and complexity as regards how to comply with the legal requirements, and the subsequent threat of potential legal action, generate costs that present an unnecessary barrier to the development of CSD activities. A CSD reported confidentially[390] that the internal legal support required throughout the passporting process was significant, including: interpretation of Article 23 of CSDR, clarification of where passports were needed to maintain operating licenses, and preparation of local legal work. After this, passport notifications were prepared, external legal advice was

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385 "*Some authorities noted important discrepancies in the level of detail provided in respect of the measures set up by CSDs to allow their users complying with national requirements, as this is not harmonised under CSDR. Moreover, some CSDs solely seem to rely on the issuer to perform a legal analysis of the capacity of the CSD to service their issuance. Some also claimed it is not clear whether a legal opinion is needed to support the assessment. Another respondent highlighted that there are some important differences in the degree of information in the provided documentation (e.g. from very detailed information to rather limited and high-level information) and mostly in the assessments done by different CSDs. Some CSDs provided independent legal opinions, some provided internal assessment and others estimated that an assessment of each national requirement under Article 49 of CSDR was not necessary, due to the typology of services/instruments the CSD provided.*", ESMA Report on cross-border services (see note 50), para. 107.

386 Based on confidential information provided to DG FISMA services.

387 CSDR Q&A (see note 164), CSDR Question 9(g) clarifies the role of host NCAs. Q&As are not legally binding.

388 To question 10 of the targeted consultation on whether they have encountered any particular difficulty in the process of obtaining the CSDR "passport" in one or several Member States different to the one of the place of establishment, 12 responded positively, 7 did not have an opinion while none of the respondents answered negatively.

389 Euronext response to the Commission CSDR targeted consultation (see note 106), page 16.

390 Based on confidential information provided to DG FISMA services.

sought,[391] and comments from host national authorities had to be addressed. Another CSD stated confidentially[392] that the CSD had to do most of the work rather than external lawyers; consequently, in most cases, it was not achievable or realistic that the legal opinion cover the compliance of the CSD's procedures with the local laws. Even if most CSDs applying for a passport to operate cross-border have been able to obtain it, stakeholders have indicated that this process is difficult, lengthy and demanding (see section 2.3.1).

Second, the rules around the provision of banking services create disproportionate compliance costs for CSDs. This negatively impacts the provision of cross-border services. In addition, the lack of options to settle in either commercial bank money or central bank money could undermine the safety of the settlement market, as transactions could be settled free of payment instead of delivery versus payment, increasing risks for the market as a whole.[393] More specifically:

- CSDs offering settlement in commercial bank money as an ancillary service must comply with **additional requirements** to mitigate mainly **credit and liquidity risks for the CSD and its participants,[394]** e.g. CSDs have to be authorised as a credit institution under the applicable banking legislation and comply with the regulatory capital requirements set in Regulation (EU) No 575/2013 (Capital Requirements Regulation). This has led to a doubling of regulatory capital and significant investments in operational compliance relative to the situation where only CSDR would be applicable.[395] At end 2020, the level of regulatory capital of a CSD with a banking licence estimated to be more than twice the amount compared to the situation where it had to comply only with CSDR and without taking into account the number of staff responsible for assessing, controlling and mitigating the banking risks taken by the bank.[396] In addition, CSDR does not allow banking CSDs to offer their services to other (non-banking) CSDs irrespective of whether the latter is within or outside their group.[397] As a result of the increased costs, **only 5 out of 28 CSDs in the EEA** have applied and been authorised to provide banking services;[398] all provided these services pre-CSDR and no new providers have entered the market. Moreover, one CSD stopped providing issuance and settlement services in currencies other than the Euro.[399]
- CSDs offering settlement **above a certain threshold may also use a specialised bank** (known as a designated credit institution, which is a limited-licence bank introduced by CSDR that provides services only to CSDs) that has to comply with additional requirements to mitigate the risks. Nevertheless, considering the **costs required to be authorised as a designated credit institution** and the limited range of services that such entities can offer, **no designated credit institutions exist to date** as a business case is difficult to make, as confirmed by

[391] In addition to the internal legal support, it is in practice impossible to provide a formalised assessment per market and per type of securities in all EEA countries without external legal advice.
[392] Information provided to DG FISMA services confidentially.
[393] European Post-Trade Forum Report (see note 11), p. 117.
[394] Credit risk is the risk an institution faces when lending to borrowers that cannot meet their obligations. Liquidity risk refers to the inability of an institution to meet its own financial obligations.
[395] Based on confidential information provided to DG FISMA services.
[396] Based on confidential information provided to DG FISMA services.
[397] Article 54 of CSDR.
[398] ESMA CSD Register (see note 26).
[399] Based on confidential information provided to DG FISMA services.

ESMA.[400] Therefore, while this was an option in CSDR, CSDs cannot use it **to settle in commercial bank money. Consequently, CSDR does not achieve its objective**. The decision of BNY Mellon to stop its CSD project in 2015 can be attributed to the restrictions imposed on designated credit institutions.[401]

- CSDs settling **in commercial bank money below a certain threshold**, do not have to comply with all credit and liquidity requirements (i.e. they can use a commercial bank).[402] However, this means that they have to **limit the offer of their services in other currencies in order not to exceed the threshold of 1% of total settlement and EUR 2.5 billion**, thus incurring opportunity costs from the loss of business. For example, in northern Europe, CSDs without access to central bank money, such as Finland, Sweden and Denmark are confronted directly with this limit, limiting possibilities for cross-border transactions between these countries.[403] Estimates are that, for CSDs without a banking license, settlement activities in foreign currencies could potentially increase over a 5-year horizon by ca. 5% of the total value of all securities transactions against cash settled in the books of such CSDs.[404] The majority of stakeholders responding to the Commission targeted consultation, including CSDs and their association suggested a reassessment of the threshold set out in Article 54(5) of CSD.[405] New entrant CSDs wishing to offer settlement services throughout the EU (and thus likely to require commercial bank money settlement facilities) may also be discouraged from entering the EU market due to the conditions for settlement in commercial bank money, which were introduced to ensure financial stability.
- Contributing to the reluctance of market participants could be the intensive process to obtain a banking authorisation. For CSDs already authorised to provide these services, the average time to receive the authorisation after the application was deemed complete was approximately 6 months, as prescribed by CSDR. In practice however, it can take up to two to three years for the application to be deemed complete by the national authorities.[406]

Third, the rules on settlement discipline,[407] although not yet applicable, would potentially create disproportionate compliance costs for CSDs and market participants according to evidence provided by the majority of stakeholders.

To ensure the safety of settlement, any participant in a securities settlement system should settle its obligation on the intended settlement date ("ISD"); a settlement fail occurs when a transaction does not settle on that date.[408] The settlement discipline regime aims to encourage market participants to avoid settlement fails; its **two main elements** are the measures to prevent settlement fails (Article 6 of CSDR) and the measures to

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400 ESMA Report 'Provision of banking-type ancillary services under CSDR' (see note 88), p. 4.
401 European Post-Trade Forum Report (see note 11), p.117.
402 Based on confidential information provided to DG FISMA services.
403 European Post-Trade Forum Report (see note 11), p. 117.
404 Based on the anonymised and consolidated outcome of a survey conducted among CSDs provided by the ESCB.
405 Summary Report of the Commission CSDR targeted consultation (see note 92).
406 ESMA Report 'Provision of banking-type ancillary services under CSDR' (see note 88) p 10.
407 Articles 6 and 7 of CSDR.
408 CSDR defines settlement fails as the non-occurrence of settlement, or partial settlement of a securities transaction on the intended settlement date, due to the lack of securities or cash and regardless of the underlying cause (Article 2(15) of CSDR).

address settlement fails (Article 7 of CSDR). The latter comprise two main pillars; cash penalties and mandatory buy-ins. CSDs would be required to impose **cash penalties** on their participants in case of settlement fails. If despite the cash penalties, a CSD participant (original seller) fails to deliver the securities, it will be subject to **a mandatory buy-in**. A buy-in provides **the buyer of securities** with the right to buy the securities elsewhere, cancel the original transaction and put the costs of the buy-in, as well as any price difference, with the original seller.[409]

The original objective of the settlement discipline regime as contained in the Commission proposal[410] was to address high settlement fail rates, but mainly to harmonize the diverse market discipline measures across EU capital markets. Hence the proposed settlement discipline measures were general, with detailed technical standards to be set in secondary legislation[411]. The final set-up of the settlement discipline measures became evident to the market participants only when the 2018 regulatory technical standard[412] (RTS) was published. Furthermore, only the period of market volatility of spring 2020 triggered reflections about the potential impact of the regime on trading conditions or their ability to fulfil certain market functions.

Entry into force of the settlement discipline regime could provide a strong incentive for all market participants to improve back-office capacity and operations to handle post-trading functions. The higher EU fail rates seem to stem from operational and structural factors; a lack of cash does not seem to be typically the issue.[413] These deficiencies include understaffing, fragmented IT infrastructure and systems or highly manual procedures and lack of straight-through-processing. Insufficient operational post-trade capacities may lead to incorrect settlement instructions (miscommunication, human error etc.) that cannot be matched by CSDs.[414]

The settlement discipline regime would however create both high one-off (i.e. connecting to buy-in agents, repapering existing contracts to take account of mandatory buy-in rules) and ongoing costs (i.e. in terms of pricing and reduced liquidity of instruments potentially at risk of being bought-in or trades being abandoned or migrating to non-EU trading venues (see section 2.3.4)).

Evidence provided seems to show that these costs are disproportionate and would stem both from the **lack of clarity around the rules governing the process** (i.e. what transactions are in-scope or how to use buy-in agents), and from the **framework's impact on market conditions** (deterioration of liquidity for some instruments, higher bid-ask spreads) and **market participants' trading behaviour** (migration of trading from peripheral instruments to liquid instruments, doubts around the viability of the market maker role for less liquid instruments). The costs of applying **in particular the rules on mandatory buy-in** could outweigh their benefits **for three main reasons:**

First, even though the settlement discipline regime did not yet apply **in the early days of the Covid-19 pandemic (i.e. March/April 2020)**, the crisis gave stakeholders the opportunity to reflect on how it would have impacted the market if it were in place.[415] In

[409] More details regarding the buy-in process is included in Annex 9.
[410] COM (2012) 73 final
[411] See the Impact Assessment supporting the 2012 CSDR proposal. See SWD92012) 22 final, Option 1.1.2: Introduce common EU principles for settlement discipline
[412] Commission Delegated Regulation (EU) 2018/1229
[413] 'ESMA Report on trends, risks and vulnerabilities', No.2, 2021, ESMA50-165-1842.
[414] Based on confidential information provided to DG FISMA services.
[415] Summary Report of the Commission CSDR targeted consultation (see note 92).

essence, **mandatory buy-ins could have exacerbated the negative impacts linked to the crisis; in particular they could have increased liquidity pressure and increased the costs of securities at risk of being bought-in.**[416]

For instruments where there are few available buyers and sellers, market makers play a key role by taking risk onto their balance sheet to provide immediate execution to clients. For these securities, market makers[417] are an important source of liquidity and thus often offer securities they do not hold,[418] based on the reasonable assumption of sourcing these securities when necessary. For securities not held on their balance sheet, or which cannot be readily sourced, the introduction of a mandatory buy-in regime under CSDR would fundamentally impact the ability of market makers to make markets. To adjust for the expected cost of being bought-in, market makers will have to add a premium to their prices – which will widen the bid-offer spread (which will in turn increase costs to end-investors) – or they may simply not make an offer price on an enquiry thereby negatively affecting market liquidity.

Although these liquidity effects are most pronounced in choices made by market makers, all investors, even in liquid securities, could face similar trade-offs between entering into a trade (providing liquidity), the availability of the instrument and the cost of being bought-in. The impacts are likely to be reflected in behavioural change, rather than a price adjustment. For instance, according to feedback from the targeted consultation, lenders of bonds might become less inclined to lend, to reduce the risk that they get bought in if they sell securities on loan which cannot be recalled on time.[419] During periods of market stress, in particular as investors hoard cash and withdraw the less risky instruments, some securities, especially those with limited availability, **will experience further deterioration of liquidity resulting in increased settlement fails**.

If during this period of market stress mandatory buy-ins had been in place, participants would have had to buy back the securities that already had limited availability and therefore would **have added liquidity pressure on them.**[420] Investors would have chased a small number of available securities, **driving up prices** and potentially, **further driving volatility in a stressed market**. The costs of mandatory buy-ins for market participants (that have to buy exactly these securities) would thus have increased, making it **even more difficult for market participants to manage**. One estimate is that the **volume of buy-ins in corporate bonds would have more than doubled** during the Covid-19 market turmoil, compared to normal market conditions.[421] This would have led to a noticeable increase in the cost of these instruments, illustrated by bid-offer spreads. According to one bank, the application of mandatory buy-ins to EU government bonds

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[416] More than half of respondents to the targeted consultation, all categories included, considered that the CSDR settlement discipline regime would have had a significant negative impact on the market if it had been in place during the market turmoil provoked by Covid-19. Summary Report of the Commission CSDR targeted consultation (see note 92).

[417] By providing a buy and sell price for securities (bid-ask spread) market makers establish liquidity and pricing, and help end-investors to redeem funds or transact in a timely fashion in instruments for which there may not be a counterparty with an immediate opposite intention.

[418] Market makers aim to run low levels of inventory since high levels of inventories have high risk, capital and funding costs.

[419] Especially during a credit crunch, this effect could be amplified as lenders would want to have the ability to sell holdings at short notice to raise cash liquidity and the amount they will be willing to lend will be further reduced

[420] Based on responses to the Commission CSDR targeted consultation from AFME, Association of German Banks, EFAMA, et al.

[421] Based on confidential information provided to DG FISMA services.

could have led to a 50%-100% increase in bid-offer spreads depending on the size and the status of the markets.[422]

Second, the settlement discipline regime could also give rise to unintended consequences for the competitiveness of the EU capital markets. Capital markets outside the EU do not have a settlement discipline regime as strict as that of the EU;[423] e.g. the UK announced it is not implementing the CSDR settlement discipline regime.[424] Investors may therefore be tempted, in light of the increased costs of trading EU securities due to the higher price for their settlement, to focus on other markets for the settlement of their transactions. In particular mandatory buy-ins may create an additional cost and risk for EU-settled securities that could disadvantage EU companies compared to their global peers. Wider spreads and less liquidity will reduce the investment returns of pension funds, asset managers and, ultimately, end investors, which, according to some stakeholders, could risk driving issuance, trading and investment activity outside of the EU.[425] One firm stated that they would limit their activity and stop providing liquidity to EU investors for emerging markets and US high grade and high yield bonds, where the majority of liquidity comes from outside of Europe, because of the potential cost of these rules.[426] This would limit access to global liquidity for EU investors, as foreign investors will be unlikely to assume the costs and risks involved. This would be detrimental to EU businesses that would face a lower demand for their securities, but also for EU financial infrastructures and CMU. **It is worth noting that non-EU/EEA investors hold around 22% of European-issued securities**. The impact of the entry into force of mandatory buy-ins could therefore lead to a potentially major loss of counterparties and liquidity for the EU capital market.[427] A significant part of the EU capital market may hence be affected, depending on where transactions are settled, with liquidity and pricing heavily favouring non-EEA settlement and trading. The potential negative impact on the attractiveness of the EU market would be at odds with the objectives pursued by the settlement discipline regime and CSDR as a whole to make the EU capital market more attractive by increasing the safety of settlement.

Finally, against the above arguments, it should be noted that despite the dramatic increase in trading (settlement instructions increased by 30% between 2015 – 2019 in

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422 Based on confidential information provided to DG FISMA services.

423 During the CSDR consultation process stakeholders referred to SHO Regulation and SEC Rule 204, which however relates only to short-selling and the obligation that broker and dealer must close-out unresolved equities transactions. This was introduced to discourage the market from naked short-selling. Also examples of buy-in were given for Asian markets, in particular Singapore Exchange where any unsettled buy-in trade is carried forward to the next business day for settlement. If the buy-in and procurement remains unsuccessful by ISD +6, cash settlement will be initiated against the seller to provide resolution of the sale trade. However the Singapore Exchange has a very low failure rate because of DvP and very few trades go to buy-in.

424 Written statement by Chancellor of the Exchequer on 23 June 2020, https://questions-statements.parliament.uk/written-statements/detail/2020-06-23/HCWS309. In the meantime the UK will continue to apply CREST settlement discipline rules on failed transactions (p.37): https://www.crh.com/media/3376/crest-rules-january-2021.pdf It provides for fines on either failed bought or sold transactions.

425 See AFME response to the Commission CSDR targeted consultation, p. 36, https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME_CSDR_CP_Response_Final.pdf.

426 Based on confidential information provided to DG FISMA services.

427 'Who Owns the European Economy? Evolution of the Ownership of EU-Listed Companies between 1970 and 2012', The European Savings Institute & INSEAD OEE Data Services, 2013, https://ec.europa.eu/info/sites/default/files/file_import/1308-report-who-owns-european-economy_en_0.pdf.

EU CSDs[428]) **the settlement fail rate has remained relatively stable in the EU, both as a share of value and number of total transactions (See Annex 8, Figure II).** More specifically, for debt instruments there is a clear **decrease in settlement fails** (as a % of total number of transactions) compared to 2015, both for corporate (from 5% to 3.5% in January 2021) and government bonds (from 3% to 2% in January 2021). In terms of failed settlement instructions as percentage of value of settlement instructions, corporate bonds remain at a low and stable rate (ca. 2% since 2015), while the ratio for government bonds has increased (from 2% in January 2018 to 3% in January 2021),[429] implying fails among bonds with a higher face value. For equity products the picture is less clear. Settlement fails, calculated as percentage of total number of transactions, fell to 3% before the Covid-19 market turmoil, but have since increased again to 4.5%. In terms of settlement fails as percentage of value, the ratio has increased to 9% in January 2021 from 6% before March 2020.[430] Only recently has ESMA recorded a slow improvement in the settlement rate for equities, while the failure rate for debt instruments recovered quicker.[431] It should be noted however that between January 2018 and March 2020 the settlement fails rate for equities was low and stable, both as a share of total value (6%) and total number (3%) of equity transactions.[432] This indicates that that in normal market circumstances settlement in the EU can be relatively efficient. Finally, in the case of fixed income instruments, data seems to show that the majority of fails are resolved before the end of the notional extension period. For instance, approximately 1.5% of corporate bonds were still not settled at ISD + 7, compared to 0.2% of sovereign bonds.[433] In absolute terms, this approximately equates to an estimated 1250 buy-ins per business day, for one CSD and one instrument type. In relative terms, the buy-in regime targets a small proportion of the total volume of transactions but will necessitate an impact on the pricing and liquidity on a much larger percentage of overall transactions.[434]

However, even if settlement efficiency in the EU seems to be stable or improving slightly, fail rates in the EU still remain higher than in, e.g. the US where about 2% of all US treasuries and mortgage backed securities transactions fail.[435] Different levels of settlement efficiency between national capital markets can partly explain the lower overall EU settlement efficiency.[436] The top five EU Member States had a settlement efficiency[437] between 0.20% - 0.44% in 2020. Comparable figures for the least performing five Member States ranged from 4.76% - 13.80%. This illustrates that there

[428] Data generated through the Securities Trading, Clearing and Settlement Statistics Database, European Central Bank, https://sdw.ecb.europa.eu/browse.do?node=9691131.
[429] See Figure II, Annex 8. Based on confidential data provided to DG FISMA services.
[430] See Figure II, Annex 8. Based on confidential data provided to DG FISMA services.
[431] 'ESMA Report on trends, risks and vulnerabilities", ESMA50-165-1524, No. 1, March 2021.
[432] A higher settlement fail rate for equities compared to debt products can be explained by the fact that equities are more likely to form part of a chain of settlement fails. A staff paper by the Bank of England found that only a small proportion of fails (17%) in the highly liquid FTSE100 securities was not part of a cascade of fails. By contrast, for gilts more than 40% that failed was not involved in a cascade of fails. Source: "Securities settlement fails network and buy-in strategies", Gurrola-Perez, P., He J. & Harper, G., Staff Working Paper No. 821, Bank of England, September 2019.
[433] See AFME response to the Commission CSDR targeted consultation, Q. 34.1 based on data provided by Euroclear Bank for the fixed income market in 2020 (see note 127).
[434] Ibid.
[435] K. Burne, 'How to succeed in fixing settlement fails', Aerial View, Bank of New York Mellon, 2020.
[436] Based on confidential information provided to DG FISMA services.
[437] Calculated as percentage of total value of all transactions, equity and debt combined. Looking at settlement efficiency as percentage of total number of transactions, the best and worst performing Member States are broadly similar.

seems to be still some room for improvement in the EU's settlement efficiency, in some instruments more than others. Nevertheless, these small improvements, need to be balanced against the potential disproportionate costs of investing in the settlement discipline regime and applying it over time.

3. *Insufficient insight into the activities of third-country CSDs*

Under CSDR, third-country CSDs providing services in the EU provide **insufficient insight into their activities in relation to financial instruments constituted under the law of a Member State**, in particular when they provide services under the grandfathering clause (see section 2.3.5). This leads to potential risks for the whole settlement ecosystem, and in particular could have negative impacts on three groups of stakeholders: EU authorities, EU CSDs and issuers.

First, **EU authorities are not aware of the activities of third-country CSDs** in the EEA, a fact underlined both by ESMA and several respondents to the targeted consultation; ESMA itself recognised that "*... there is no information available either at EEA level (ESMA, European Commission) or at the level of NCAs as to the activity of TC-CSDs* [third-country CSDs] *in the EEA, unless provided by the TC-CSDs on a pure voluntary basis*"[438]. Some third-country CSDs operating in the EU are not subject to any notification requirement for their activities with respect to securities constituted under the law of a Member State (see section 2.3.5). EU authorities therefore have no information on which services they provide, their volume or the Member States affected by them. This means that, if needed, neither issuers nor public authorities at national and EU level can assess the impact of these CSDs on the **financial stability of the EU which may in itself create a risk to financial stability**.

Second, there is an **uneven playing field between EU CSDs and third-country CSDs** as these latter are not required to comply with rules at least equivalent to CSDR for their activities in relation to financial instruments constituted under the law of a Member State.

Third, **the lack of information on third-country CSDs' activities may create a risk for investors**. The Commission has not assessed the rules to which CSDs operating under the grandfathering clause are subject, despite the fact that they provide services in relation to the same financial instruments EU CSDs do (see section 2.3.5). The lack of information on those CSDs' activities may create a risk for investors where the legislation governing them does not offer the same level of protection as EU legislation.

[438] ESMA letter to the European Commission, 'ESMA's Proposals regarding the Review of the CSD Regulation (CSDR), 20 May 2021, https://www.esma.europa.eu/sites/default/files/library/esma70-156-4519_letter_to_ec_-_csdr_review.pdf .

Annex 7: Analysis of all the options

This section describes the costs and benefits of each policy option on the drivers.

1. Impact of the policy options regarding passporting requirements

1.1. Option 2 - Reduce the scope of the passporting requirements

Cost-benefit analysis

- *CSDs:* Any EU CSD would be able to provide services for non-equity instruments within the EU without being subject to a passporting process, increasing their potential to expand cross-border, and thus benefit from potential economies of scale and scope. This benefit would be ongoing. However, the unclear and burdensome passporting requirements, for equities would remain, creating cross-border barriers for CSDs, reducing competitiveness. This cost would be ongoing.
- *Issuers:* Issuers would be positively impacted as it would increase cross-border activities for non-equity securities, e.g. bonds. It would therefore mean more choice and competition between CSDs and more offers for issuers. This benefit would be ongoing. However, as the benefits would be limited to non-equities, the problems identified would remain for equity securities, limiting the potential benefits for issuers.
- Investors: Investors would be positively impacted as it would increase cross-border activities for non-equity securities, e.g. bonds. It would therefore mean more choice and competition between CSDs. This benefit would be ongoing.
- *ESMA*: No impact identified.
- *NCAs:* NCAs of host Member states would not have a clear overview on the services provided for non-equity instruments by CSDs established outside their jurisdiction and the risks that they may or may not entail. This cost would be ongoing.

1.2. Option 3 - Clarify the role and powers of competent authorities and requirements related to national laws

Cost-benefit analysis

CSDs: CSDs could have a clearer view on the passporting requirements, hence accelerating the passporting process and spending less time and costs on understanding the different requirements. This benefit would be ongoing. Clarifications could therefore lead to some improvements in cross-border activities. However, the burden of requesting an approval from the host Member State regarding the analysis of the measures to be taken by the CSD to allow its participants to comply with the requirements related to national laws would still remain even if clarified. Should a CSD wish to passport in 26 Member States to be able to provide services throughout the EU, it is estimated that it would cost on average at least EUR 780 000 for the CSD (see section 2.3.1). Should the simplified passporting process reduce by 15% the costs of passporting, this CSD would be saving, on average, EUR 117 000. Currently 15 CSDs are providing services cross border in at least one Member State. If the notification process enables at least 10 other CSDs to passport in 26 Member States this would help to save on average EUR 1 170 000 for

CSDs. This would be a one-off benefit for CSDs.[439] Ongoing costs of monitoring compliance with the passport would also be slightly reduced. Should a CSD had passported in 26 Member States to be able to provide services throughout the EU, it is estimated that it would cost on average at least EUR 52 000 (see section 2.3.1). Should the simplified process reduce by 15% the costs of passporting, this CSD would be saving, on average, EUR 7 800. Currently 15 CSDs are providing services cross border in at least one Member State. If the simplified process enable at least 10 other CSDs to passport in 26 Member States this would help to save on average EUR 78 000 for CSDs per year. This would be ongoing benefit for CSDs.

- *Issuers:* If the simplification of the passporting requirements leads to some improvements in cross-border activities, issuers can benefit from a more diversified offer from CSDs. This benefit would be ongoing.
- Investors: If the simplification of the passporting requirements leads to some improvements in cross-border activities, investors can benefit from more competition between CSDs. This benefit would be ongoing.
- *ESMA*: ESMA would have a clearer view on the passporting requirements, and therefore would spend less time to clarify them. This benefit would be ongoing.
- *NCAs:* NCAs would have a clearer view on the passporting requirements, hence spending less time on understanding them. In addition, it would remove the uncertainty as regards the role of the host NCA. This benefit would be ongoing. However, the burden of requesting an approval from the host Member State regarding the analysis of the measures to be taken by the CSD to allow its participants to comply with the requirements related to national laws would still remain even if clarified.

  Should a CSD wish to passport in 26 Member States to be able to provide services throughout the EU, it is estimated that it would cost to national authorities altogether at least EUR 79 000 (see section 2.3.5). Should the simplified process reduce by 15% the costs of passporting, the 26 national authorities would be saving all together, on average, ca. EUR 11 800. Currently, 15 CSDs are providing services cross border in at least one Member State. If the simplified process enables at least 10 other CSDs to passport in 26 Member States this would help to save ca. EUR 118 000 for 27 national authorities. This would be a one-off benefit for NCAs.

1.3. Option 4 - Replace the passporting procedure at the level of the host Member State with a simple notification

Cost-benefit analysis

- *CSDs:* The passporting requirements related to national laws and the role of NCAs are the ones that raised most issues. Removing the possibility for the host Member State competent authorities to refuse a passporting request would alleviate, clarify and speed up the passporting process. This benefit would be ongoing.

  Should a CSD wish to passport in 26 Member States to be able to provide services throughout the EU, it is estimated that it would cost on average at least EUR 780 000 per CSD (see section 2.3.1). Should the simplified process reduce by 75% the costs of passporting, this CSD would be saving, on average, EUR 585 000. Currently 15

[439] Commission estimates based on confidential information provided to DG FISMA services.

CSDs are providing services cross border in at least one Member State. If the simolified process enables at least 10 other CSDs to passport in 26 Member States this would help to save ca. EUR 5 850 000 for CSDs. This would be a one-off benefit for CSDs.[440]

Ongoing costs of monitoring compliance with the passport would also be significantly. Should a CSD had passported in 26 Member States to be able to provide services throughout the EU, it is estimated that it would cost on average at least EUR 52 000 (see section 2.3.1). Should the simplified process reduce by 75% the costs of passporting, this CSD would be saving, on average, EUR 39 000. Currently 15 CSDs are providing services cross border in at least one Member State. If the simplified process enables at least 10 other CSDs to passport in 26 Member States this would help to save ca. EUR 390 000 for CSDs per year. This would be ongoing benefit for CSDs.

- *Issuers:* Issuers could be positively impacted as it would increase cross-border activities. It would therefore mean more choice and competition between CSDs and more offers for issuers. This benefit would be ongoing.
- *Investors:* If the simplification of the passporting requirements leads to some improvements in cross-border activities, investors can benefit from more competition between CSDs. This benefit would be ongoing.
- *ESMA*: The simplified process would alleviate their costs as the passporting requirements would be streamlined and clearer.
- *NCAs:* By replacing the passporting procedure at the level of the host Member State by a notification, NCAs will alleviate the costs and time spent on passporting; however, at the same time, NCAs would have less oversight on the measures taken by the CSDs to allow their users to comply with the national law referred to in Article 49(1) and also no power to oppose the passporting. At the same time, the simple fact that NCAs would have less oversight does not mean that CSDs would not have to continue applying national laws. In addition, as a notification procedure would still remain in place, it would ensure adequate information to monitor risks for the authorities.

  Should a CSD wish to passport in 26 Member States to be able to provide services throughout the EU, it is estimated that it would cost to national authorities altogether at least EUR 79 000 (see section 2.3.5). Should the simplified process reduce by 75% the costs of passporting, the 26 national authorities would be saving all together, on average, ca. EUR 59 000. Currently, 15 CSDs are providing services cross border in at least one Member State. If the simplified process enables at least 10 other CSDs to passport in 26 Member States this would help to save on average EUR 590 000 for 27 national authorities. This would be a one-off benefit for NCAs.

1.4. Combination of Option 3 and Option 4

Cost-benefit analysis

CSDs: CSDs could have a clearer view on the passporting requirements, hence accelerating the passporting process and spending less time and costs on understanding the different requirements. This benefit would be ongoing.

[440] Commission estimates based on confidential information provided to DG FISMA services.

Clarifications could therefore lead to some improvements in cross-border activities. Further, the burden of requesting an approval from the host Member State would be removed. This would be a one-off benefit for CSDs, although ongoing costs of monitoring compliance with the passport would also be slightly reduced.

More details on the quantified costs and benefits are included in Section 1.2 and 1.3 of this Annex, regarding options 3 and 4.

- *Issuers:* If the simplification of the passporting requirements leads to some improvements in cross-border activities, issuers can benefit from a more diversified offer from CSDs. This benefit would be ongoing.
- *Investors:* If the simplification of the passporting requirements leads to some improvements in cross-border activities, investors can benefit from more competition between CSDs. This benefit would be ongoing.
- *ESMA*: ESMA would have a clearer view on the passporting requirements, and therefore would spend less time to clarify them. The simplified process would also alleviate their costs as the passporting requirements would be streamlined and clearer. This benefit would be ongoing.
- *NCAs:* NCAs would have a clearer view on the passporting requirements, hence spending less time on understanding them. In addition, it would remove the uncertainty as regards the role of the host NCA. This benefit would be ongoing. Further, the burden of requesting an approval from the host Member State would be removed, which will alleviate the costs and time spent on passporting. This would be a one-off benefit for NCAs.

  However, NCAs would have less decision making powers on the measures taken by the CSDs to allow their users to comply with the national law referred to in Article 49(1) and also no power to oppose the passporting. At the same time, the simple fact that NCAs would have less oversight does not mean that CSDs would not have to continue applying national laws. In addition, as a notification procedure would still remain in place, it would ensure adequate information to monitor risks for the authorities. Finally, NCAs could benefit for a compensatory increase of oversight on passported CSDs through the establishment of mandatory colleges, which would allow them to have an ongoing oversight rather than a one off possibility to refuse a passport.

2. IMPACT OF THE POLICY OPTIONS REGARDING COOPERATION BETWEEN AUTHORITIES

2.1. Option 2: Enhance the existing CSDR rules for cooperation arrangements

Cost-benefit analysis

- *CSDs:* CSDs benefit from a reduction of costs as a result of addressing partly the barriers to cross-border settlement and the lack of supervisory convergence. This benefit would be ongoing.
- *Issuers:* Issuers would benefit from the partly improved cross-border provision of services and supervisory convergence as well as from increased financial stability. This benefit would be ongoing.
- *Investors:* Investors would benefit from the partly improved cross-border provision of services and supervisory convergence as well as from increased financial stability. This benefit would be ongoing.

- *NCAs:* NCAs may incur limited additional costs arising from their participation to the cooperation arrangements. Nonetheless, they will benefit from slightly increased access to information and powers to monitor risks compared to today. This benefit would be ongoing.
- *ESMA:* No impacts for ESMA or, in case the framework is amended to provide for ESMA participation to the cooperation arrangements, limited additional [ongoing] costs.
- *Banks:* no impact identified.

2.2. Option 3: Introduce mandatory supervisory colleges

Cost-benefit analysis

- *CSDs:* By addressing, even partly, the barriers to cross-border settlement and the absence of supervisory convergence, CSDs would benefit (to a greater extent when compared to option 1) from a reduction of costs when operating in the EU. This benefit would be ongoing.
- *Issuers:* would benefit (to a greater extent when compared to option 1) from the partly improved framework for the cross-border provision of services, the increased supervisory convergence and financial stability. This benefit would be ongoing.
- *Investors*: would benefit (to a greater extent when compared to option 1) from the partly improved framework for the cross-border provision of services, the increased supervisory convergence and financial stability. This benefit would be ongoing.
- *NCAs:* NCAs may incur limited additional ongoing costs arising from their participation to colleges. Nonetheless, at the same time, their ongoing costs will be reduced due to the streamlined cooperation of authorities and their increased access to information and powers to monitor risks compared to today.
- *ESMA:* ESMA may incur additional costs from its participation to colleges. It is estimated that such additional costs may range from about EUR 130 000 to EUR 260 000 per annum depending on the number of CSDs for which colleges could be established and their powers.[441] However, ESMA would be able to benefit from the experience it has already acquired in the field of colleges under EMIR, and therefore very limited, if any, one-off operational costs are envisaged.
- *Banks:* no impact identified.

2.3. Option 4: More supervision of CSDs at EU level

Cost-benefit analysis

- *CSDs:* By removing the barriers to cross-border settlement and the absence of supervisory convergence, CSDs would benefit from a significant reduction of costs when operating in the EU. This benefit would be ongoing. Nevertheless, if the costs of EU supervision were passed to CSDs, they would face higher costs.
- *Issuers:* Issuers would benefit from the free provision of cross-border services, the increased supervisory convergence and financial stability. This benefit would be ongoing.

[441] Commission estimates based on confidential data provided to DG FISMA services.

- *Investors*: Investors would benefit from the free provision of cross-border services, the increased supervisory convergence and financial stability. This benefit would be ongoing.
- *NCAs:* NCAs ongoing costs would be significantly reduced (depending on the model of single supervision to be chosen), as authorisation and supervisory powers would be moved at EU level.
- *ESMA:* This would require a significant extension of supervisory capacity inside ESMA (should ESMA be retained as the single supervisor) or the creation from scratch of a single supervisor and would therefore have major budgetary consequences for the EU. According to some estimates, depending on the exact nature of ESMA's powers and the CSDs over which ESMA would exercise such powers, the budgetary implications of this option could potentially range from EUR 0.5 million to EUR 4 million per annum depending on the design.[442] These costs would be ongoing. One option would be to cover the costs via fees to EU CSDs subject to ESMA's supervision.
- *Banks*: no impact identified.

3. Impact of the policy options regarding provision of banking services related to settlement in foreign currencies

3.1. Option 2: Introduce targeted amendments for designated credit institutions

Cost-benefit analysis

In terms of specific stakeholders, the effects are estimated to be the following:

- *CSDs:* Benefit from increased opportunities for cross-border transactions as settlement in foreign currencies would become easier. Financial stability risks, however, in terms of credit and liquidity risks and concentration risks will increase depending on the relative increase in foreign currency settlement. It also could reduce the incentives to use central bank money, one of the principles of CSDR. Option 2a: broad access to foreign currencies for CSDs as all banks can step in. Option 2b: existing banking CSDs can immediately start, no establishment needed, risk management arrangements in place, greater concentration risks within these groups and risks to competitiveness for smaller non-banking CSDs vis-a-vis the usually larger banking CSDs.
- *Investors*: Investors will benefit from the increased competition and greater choice in issuance and also in terms of risk diversification. This contributes to enhanced EU capital markets through increased cross border provision of services.
- *Issuers*: Issuers will benefit from the increased competition, mainly in the area of foreign currency settlement, and also in terms of risk diversification. This contributes to enhanced EU capital markets through increased cross border provision of services.
- *NCAs/supervisory authorities:* Increase of potential financial stability risks for both options, requiring more intensive and costly monitoring by supervisory authorities.
- Banks/competition vs other CSDs: potential for unlevel playing field against banks since ancillary services will move into CSDs where the settlement takes place.

[442] Commission estimates based on confidential data provided to DG FISMA services.

3.2. Option 3: Amend the thresholds under which CSDs can use a commercial bank for banking-type ancillary services.

Cost-benefit analysis

Option 3 leaves the structure of CSDR intact (and for example CSDs risk management policies can for a large part remain in place and as such, the risks to financial stability should be minimal; credit and liquidity risks will remain limited and possibly mitigated by accommodating risk mitigating conditions. Although, there would be a potential increase in exposures to credit institutions, that could be mitigated by limiting the increase of the threshold. The calibration of the level of the thresholds could prove challenging however as only limited qualitative information is available. Broadly speaking an increase of the threshold to 5% would be sufficient to cater for expected foreign currency settlement over a time horizon of the next years, although one CSD would see a raise to 10% desirable.[443] In addition to amending the threshold, accompanying risk requirements may be set, such as minimum risk mitigation standards (e.g. creditworthiness, concentration limits) or ongoing monitoring by supervisors. These could be set via level 1 or level 2 legislation, which would provide different degrees of flexibility; level 2 could make the threshold more sustainable, flexible and adaptable as new increased thresholds could be quickly reached.

In terms of specific stakeholders, the effects are estimated to be the following:

- *CSDs:* Increasing the threshold could enable at least some CSDs to develop their services to investors both domestically and cross-border and thus obtain appropriate economies of scale to cover authorisation costs to provide banking services themselves.

  From available confidential information from stakeholders, 5 non-banking CSDs indicate that, if thresholds are amended, in total, EUR 16 billion additional settlement in foreign currencies is expected on an annual basis[444] and if we extrapolate that number to the total number of EEA non-banking CSDs (ca. 25) we arrive at an additional annual possible offering of at least EUR 80 billion of settlement in foreign currencies, without taking into account if this additional settlement would affect existing settlement in foreign currencies undertaken by CSDs already authorised to provide ancillary banking services. The additional offering of settlement in foreign currencies would tap in the identified demand, mostly in the area of bonds where a lack of offering is holding back multi-currency bond issuance.[445] Increased competition between CSDs would benefit investors in terms of pricing, possibly contributing to further enhancing demand.

  An unlikely negative effect could be the possible contagion effects on settlements through defaults of settlement agents in foreign currencies.[446] One-off costs

[443] ESCB input based on the anonymised and consolidated outcome of a survey conducted among CSDs provided by the ESCB.

[444] Current total absolute value of settlement of the CSDs and applied the growth percentages mentioned by the CSDs themselves. This gives an anticipated total of settlement in foreign currencies (settlement + corporate actions). The current absolute values in foreign currencies are then subtracted, which gives the anticipated total net gain from the proposed CSDR changes.

[445] European Post-Trade Forum Report, 15 May 2017, p. 117; https://ec.europa.eu/info/publications/170515-eptf-report_en

[446] Based on confidential information provided to DG FISMA services.

(authorisations or setting up the operational capacity) could be covered by longer term providing of the service.

- *Investors*: Investors will benefit from the increased competition, a greater choice in issuance and currency diversification in their cross-border investments.
- *Issuers*: Issuers will have more choice in terms of financing arrangements and will be able to offer a broader range of products, mainly in the area of foreign currency settlement.
- *NCAs/supervisory authorities:* Depending on the increase of the threshold and consequent financial stability risks, limited additional supervisory activity would be needed to monitor ongoing risks, such as credit and liquidity risks. As supervisory arrangements will remain the same, this will likely be more in terms of intensity and not scope of the supervision or costs.
- *ESMA:* No substantial impact. Depending on how the requirements were to be introduced, ESMA may have to develop new regulatory technical standards, possibly in cooperation with EBA and /or ECB or take further action.

3.3. Option 4: Combine amending the thresholds (option 2(b)) with allowing banking CSDs to offer banking-type ancillary services.

<u>Cost-benefit analysis</u>

When combining the options 2(b) and 3 into option 4 the costs and benefits of the respective options remain in place. However, one additional benefit would emerge. While raising the threshold for banking services to increase the notional amounts available for banking services (including foreign currency settlement) in EU settlement markets, the inclusion of banking CSDs into the potential providers of these services would increase potential notional amounts available for foreign currency settlement even further through broadening of the range of providers.

This would further enhance the impact on the CMU as this could positively impact capital markets and financing across borders and with other currency areas.

In terms of specific stakeholders, the effects are estimated to be the following, <u>relative to the options 2 and 3</u>:

- *CSDs:* Increased availability of banking services, including foreign currency services due to combined increase of availability of for example foreign currency settlement and broadening of the provider base.
- *Investors*: Investors will benefit from the further increased competition, a greater choice in issuance and currency diversification in their cross-border investments.
- *Issuers*: Issuers will have more choice in terms of financing arrangements and will be able to offer a broader range of products, mainly in the area of foreign currency settlement.
- *NCAs/supervisory authorities:* -
- *ESMA:* No impact.

4. Impact of the policy options regarding settlement discipline

The objective of this option is to minimise the burden and compliance costs of the settlement discipline regime, avoid negative impacts on EU capital markets, while ensuring a high degree of settlement efficiency.

4.1. Option 2 – Introduce targeted amendments for cash penalties and mandatory buy-ins

Cost-benefit analysis

- *CSDs/CCPs:* CSDs would benefit from the introduction of a single process for the treatment of penalties as well as clarifications with regards to in-scope transactions. A duplicative operational process could create new cross-border risks.
- *Investors*: Benefits from amendments to the pass-on mechanism would be permanent, as they would reduce the number of buy-ins required to remedy settlement fails. It would also create greater flexibility and increases the possibility that the buy-in can be actioned. According to one estimate the introduction of a pass-on mechanism would reduce costs by 37.5%[447]. Furthermore, market participants will benefit from a clear identification of in-scope transactions reducing the number of transactions that cannot be resolved (i.e. transactions outside the participants or primary market transactions for Exchange Traded Funds).

  Sunk cost related to the setting up of a buy-in agent offering, although only one service provided has emerged so far. The total costs include setting up the infrastructure and personnel costs.

  To comply with the buy-in requirements, with IT, HR and consulting costs, it is estimated that the average cost per market participant to set up a connection to a buy-in agent would be around EUR 1 million over 4 years, amounting to EUR 1.5 billion for all in-scope market participants in the EU[448]. Although Option 2 will offer savings to market participants as it will allow for alternative solutions, it is likely that some market participants will still choose to have access to a buy-in agent and will incur the additional costs. This would be a one-off cost.
- *Issuers:* Issuers will in particular benefit from the removal of certain corporate actions on stock (e.g. initial creation transactions and redemptions) or primary market operations[449] from the scope of the settlement discipline regime. These changes would permanently reduce the compliance burden on market participants by removing transactions that do not form part of market turnover.
- *NCAs/ ESMA:* Amendments to the pass-on mechanism would be beneficial as fewer buy-ins would contribute to market stability. A clear determination of in-scope transactions would also lessen the administrative burden on ESMA related to replying to Q&A's. Nevertheless, such modifications are also likely to require a revision of the corresponding level 2 standards relating to settlement discipline by ESMA.

4.2. Option 3 – Introduce a two-step approach

Cost-benefit analysis

[447] For explanation and calculation of costs savings see J.P. Morgan public consultation reply, Q. 34.1

[448] Based on confidential information provided to DG FISMA services.

[449] Meaning the process of initial creation of securities, whereby the securities are created, but they are not yet been subscribed for, so no capital has been raised. See AFME reply to CSDR public consultation, p.32

- *CSDs:* CSDs affected directly by the suspension of the buy-in framework, although there may be some sunk costs. Costs associated with the implementation of the penalty regime, although it is broadly prepared throughout the infrastructure. Likely higher reporting requirements as CSDs will need to provide accurate data as to the evolution of settlement efficiency to inform ESMA/ EC decision about the need to implement a mandatory buy-in. The costs associated with increased reporting requirements should not be significant as CSDs already report settlement efficiency rates regularly to ESMA.

- *Investors:* One-off costs to prepare the introduction of cash penalties, related to capacity improvements in terms of IT systems and staffing in the affected enterprises. However, the implementation of the penalty regime is already broadly prepared throughout the infrastructure and concerns about the effects are modest compared to the disadvantages of combining the penalty regime with mandatory buy-in[450]. Cash penalties will cover all unresolved trades irrespective of size. Hence the capacity improvements they will trigger will benefit both professional and retail investors. These incentives will be reinforced by the fact that mandatory buy-ins are suspended, not cancelled, so post-trade processing of smaller transactions carried out by retail investors will also improve. Deferred, one-off, repapering costs for market participants upon the potential introduction of mandatory buy-ins. Costs of potential duplicative repapering (i.e. repapering related to entry into force of the buy-in regime as from February 2022 and potential additional repapering due to potential clarifications introduced under Option 2) would be avoided.

  The major negative impacts in terms of liquidity and market stability caused by mandatory buy-ins would be, at least temporarily, avoided. Cost of settlement fail in the form of penalties on the failing party, which is currently avoided as the settlement discipline regime is not yet implemented.

  The proposed two-step approach would result in deferred cost related to the setting up of a buy-in agent service[451]. In addition the average cost per market participant to set up a connection to a buy-in agent would be around EUR 1 million, as described in Option 2. Depending on the potential targeted changes to be made to the buy-in regime, such costs savings could either be temporary (i.e. until the buy-in regime enters into force) or permanent (e.g. if the changes allow for a simplified approach regarding the requirements related to buy-in agents).

- *Issuers:* The benefits will be limited to certain primary market transactions and accrue only as long as mandatory buy-ins are deferred.

- *NCAs and ESMA*: Ongoing monitoring cost for settlement efficiency rates in national markets (NCAs) and EU (ESMA) as well as ongoing costs related to defining the appropriate terms or scope in terms of type of instrument or transaction size for the potential introduction of a mandatory buy-in.

4.3. Option 4 – Introduce voluntary buy-ins

Cost-benefit analysis

- *CSDs:* CSDs likely not affected, although ongoing reporting costs may increase as companies report buy-in irregularly. Sunk costs related to the setting up of a

[450] EBF public consultation reply, Q. 34.1

[451] Supported by confidential information provided to DG FISMA services.

buy-in service in the affected CSDs, although with the voluntary nature of buy-ins demand for their service will materialize.

- *Investors*: Negative impacts across asset classes similar to option 1, although the extent of the negative effect will depend on practical use of voluntary buy-ins by the purchasing party. Cost saving will also be limited as companies will need to maintain buy-in processes in case a counterparty demands their application.

  Market makers will find price-setting even more complicated in less liquid/ peripheral instruments as it is unclear whether the trade will be subject to buy-in.

  Voluntary buy-ins would allow investors greater flexibility in making investment choices that suit their own investment strategy and risk appetite, although evidence suggests that investors tend not to choose currently available instruments to resolve unsettled transactions.

- *Issuers:* Negative impacts related to the inconsistent application of mandatory buy-ins, leading potentially to a decrease in primary market issuance activity.
- *NCAs and ESMA:* Potentially higher monitoring costs related to market supervision and prevention of abusive market behaviour with respect to voluntary buy-ins. To incentivise the use of voluntary buy-ins as an investor's right could be enshrined in to law together with guiding principles. This would likely increase compliance costs for ESMA as market participants will regardless demand clarifications regarding the guiding principles.

4.4. Option 5 – Combining targeted amendments to settlement discipline regime with a two-step approach

<u>Cost-benefit analysis</u>

- *CSDs:* Similar benefits and costs to the ones described under Option 2 and Option 3. In general CSDs will benefit from the suspension of the buy-in framework, although there may be potentially some sunk costs. The penalty regime, is broadly prepared throughout the infrastructure. Likely higher reporting requirements as CSDs will need to provide accurate data as to the evolution of settlement efficiency to inform ESMA/ EC decision about the need to implement a mandatory buy-in. CSDs would benefit from the introduction of a single process for the treatment of penalties as well as clarifications with regards to in-scope transactions.
- *Investors:* The benefits and costs will be similar to the ones described under Option 3, although their magnitude will be increased (benefits) or decreased (costs) thanks to the clarifications contained in Option 2. In particular costs will be comparatively lower thanks to the clarifications regarding in-scope transactions, pass-on mechanism or the use of buy-in agents contained in Option 2.

  The major negative impacts in terms of liquidity and market stability caused by mandatory buy-ins would be, at least temporarily, avoided.

- *Issuers:* The benefits will be limited to certain primary market transactions and accrue only as long as mandatory buy-ins are deferred.
- *NCAs and ESMA*: Ongoing monitoring cost for settlement efficiency rates in national markets (NCAs) and EU (ESMA) as well as ongoing costs related to defining the appropriate terms or scope in terms of type of instrument or transaction size for the potential introduction of a mandatory buy-in.

5. IMPACT OF THE POLICY OPTIONS REGARDING THIRD-COUNTRY CSDS

5.1. Option 2 - Introduce an end-date to the grandfathering clause

Cost-benefit analysis

- *EU CSDs[452]:* this would indirectly positively impact EU CSDs on an ongoing basis as it would contribute to the level playing field between EU authorised CSDs and third-country CSDs which would have to comply with equivalent CSDR rules. In addition, CSDs of one Member State and one EEA country are still operating under the grandfathering clause and are still not authorised under CSDR. These CSDs have already started the authorisation process and therefore no additional costs need to be considered.[453]
- *Issuers:* it could positively affect issuers on an ongoing basis in those cases where the legislation governing third-country CSDs does not offer the same level of protection than EU legislation would. However, as very little information is available on how many third-country CSDs operate in the EU, this option, when it enters into place, may reduce the number of services offered by third-country CSDs in the EU.
- *Investors:* it could positively affect investors on an ongoing basis in those cases where the legislation governing third-country CSDs does not offer the same level of protection than EU legislation would. However, as very little information is available on how many third-country CSDs operate in the EU, this option, when it enters into place, may reduce the number of services offered by third-country CSDs in the EU.
- *ESMA*: It is currently unknown how many third-country CSDs are using the grandfathering clause and would apply for recognition to ESMA. In the 2014 impact assessment, it was assumed that ESMA could carry out its permanent tasks, in relation to non-EU CSD recognition with its existing staff.[454] Given that the task itself is unchanged, it is assume that there is no impact to the introduction of an end-date for the grandfathering clause.
- *NCAs:* no major impact identified. In case third-country CSDs benefiting from the grandfathering clause seek recognition, ESMA would consult NCAs which can slightly increase their costs.

5.2. Option 3 - Introduce a notification requirement for third-country CSDs

Cost-benefit analysis

- *CSDs[455]:* As there is very limited information, if any, available on third-country CSDs' activities operating in the EEA, this option would help to identify which third-country CSDs provide services and for which volumes, thus increasing transparency in the market for EU CSDs. This benefit would be ongoing.
- *Issuers:* Option 3 would have a positive impact on issuers as it would increase transparency in the market. This information would help to identify any potential

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[452] The cost benefit analysis mainly focuses on the costs and benefits for EEA entities and therefore the impact on third-country CSDs themselves is not included.

[453] Based on confidential information provided to DG FISMA services.

[454] .The Impact Assessment is available here: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012SC0022&from=EN.

[455] The cost benefit analysis mainly focuses on the costs and benefits for EEA entities and therefore the impact on third-country CSDs themselves is not included.

risks, in particular on financial stability and, in turn, for. This benefit would be ongoing, sustainable.

- *Investors*: Option 3 would also have a positive impact on investors as it would increase transparency in the market. This information would help to identify any potential risks, in particular on financial stability and, in turn, for investors. This benefit would be ongoing, sustainable.
- *ESMA*: Option 3 would directly positively impact ESMA as it would give the European authority more information and help it to identify and monitor risks. ESMA being at the centre of the notification process, it could also slightly increased operational. costs

  Based on Commission estimates following the submission of confidential data[456], ESMA estimated costs for one third-country CSD notification would amount to ca. EUR 2 600 per notification. Assuming that 5 third-country CSDs would notified, the costs would be estimated around ca. EUR 13 000 for ESMA. This would be one-off cost that could potentially be covered by a notification fee to be paid by each third-country CSD.
- *NCAs:* It would indirectly impact NCAs as they would get information on third-country CSDs activities through ESMA, helping them to identify and monitor risks. This benefit would be ongoing.

5.3. Option 4 – Enhance the regime for third-country CSDs providing services in the EEA

<u>Cost-benefit analysis</u>

- *EU CSDs[457]:* This option would have no direct impact on EU CSDs as it would only require third-country CSDs to be subject to a new enhanced third-country regime. As there is very limited information, if any, available on third-country CSDs' activities operating in the EEA, this option would help to identify which third-country CSDs provide services and for which volumes, thereby increasing transparency in the market for EU CSDs. This benefit would be ongoing.
- *Issuers:* It would benefit issuers in those cases where the legislation governing third-country CSDs does not offer the same level of protection than EU legislation would. It would also have a positive impact on issuers as it would increase transparency in the market. This benefit would be ongoing. However, it could also have a negative impact for issuers that use services of third-country CSDs. In case of enhancement of the regime, such issuers could lose access to the services of third-country CSDs.
- *Investors:* Similarly to the case for issuers, this option would benefit investors in those cases where the legislation governing third-country CSDs does not offer the same level of protection than EU legislation would, as well as by increasing transparency in the market. This benefit would be ongoing. However, it could also have a negative impact for investors that use settlement services of third-country CSDs which are not subject to recognition requirements for the moment. In case of enhancement of the regime, such investors could lose access to the services of third-country CSDs.

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[456] Based on confidential information provided to DG FISMA services.

[457] The cost benefit analysis mainly focuses on the costs and benefits for EEA entities and therefore the impact of on third-country CSDs themselves is not included.

- *ESMA*: the new powers given to ESMA would ensure that an EU authority has the overview of the activities of third-country CSDs, therefore increasing information helping to identify and monitor risks. However, an enhanced third-country regime, depending on its exact features, could generate significant costs for ESMA potentially in the three main following areas: (1) initial recognition of third-country CSDs, (2) ongoing monitoring and (3) exercise of ESMA supervisory powers.

  Based on Commission estimates following the submission of confidential data[458]: (1) ESMA estimated costs for the initial recognition of third-country CSDs based on a broad scope (i.e. notary service, maintenance services and settlement services) is ca. 52 000 per third-country CSD (one off cost); (2) ESMA estimated costs for the ongoing monitoring of a third CSD based on a broad scope is ca. EUR 31 000 per third-country per year (ongoing costs); (3) ESMA estimated costs to exercise supervisory powers based on a broad scope would amount to ca. EUR 78 000 per third-country CSD per year (ongoing costs).

  Based on the assumption that 5 third-country CSDs would seek recognition, it would potentially generate costs for ESMA, i.e.: (1) ESMA estimated costs for the initial recognition of third-country CSDs would amount to ca. EUR 260 000 (one off cost); (2) ESMA estimated costs for the ongoing monitoring on such CSD would amount to ca. EUR 155 000 per year (ongoing costs); (3) ESMA estimated costs to exercise supervisory powers would amount to ca. EUR 390 000 per year (ongoing costs).

  These costs would therefore be significant and it should be seen how and whether it could potentially be covered by a fee to be paid by each third-country CSD.

  Taking into account that the number of third-country CSDs potentially affected by such an option is not currently identified and that there is no indication that the activities of third-country CSDs may pose a risk for the financial stability of the EU or its Member States, this Option could be seen as premature and disproportionate.

- *NCAs:* No major impact identified. It would indirectly impact NCAs as they would get more information on third-country CSDs activities through ESMA, helping them to identify and monitor risks. This benefit would be ongoing. In addition, ESMA would consult NCAs for third-country CSDs recognition which can slightly increase their costs.

5.4. **Option 5: Combination of Options 2 and 3**

- *EU CSDs*[459]: the introduction of an end-date to the grandfathering clause would indirectly positively impact EU CSDs on an ongoing basis as it would contribute to the level playing field between EU authorised CSDs and third-country CSDs which would have to comply with equivalent CSDR rules. In addition, the introduction of an end-date to the grandfathering clause for EEA CSDs would not lead to additional costs as any EEA CSDs not yet authorised have already started the authorisation process.[460] The introduction of the notification requirement for third-country CSDs would also increase transparency in the market, benefitting also EU CSDs.

[458] Based on confidential information provided to DG FISMA services.
[459] The cost benefit analysis mainly focuses on the costs and benefits for EEA entities and therefore the impact on third-country CSDs themselves is not included.
[460] Based on confidential information provided to DG FISMA services.

- *Issuers*: the combination of Options 2 and 3 would positively affect issuers on an ongoing basis in those cases where the legislation governing third-country CSDs does not offer the same level of protection than EU legislation would while increasing transparency in the market. However, as very little information is available on how many third-country CSDs operate in the EU, the introduction of an end-date to the grandfathering clause, when it applies, may reduce the number of third-country CSDs offering services in the EU.
- *Investors*: the combination of Options 2 and 3 would positively affect investors on an ongoing basis in those cases where the legislation governing third-country CSDs does not offer the same level of protection than EU legislation would while increasing transparency in the market. However, as very little information is available on how many third-country CSDs operate in the EU, the introduction of an end-date to the grandfathering clause, when it applies, may reduce the number of by third-country CSDs offering services in the EU.
- *ESMA*: The introduction of a notification requirement for third-country CSDs would directly positively impact ESMA as it would give the European authority more information and help it to identify and monitor risks. ESMA being at the centre of the notification process, could also face slightly increased operational costs. Based on Commission estimates following the submission of confidential data[461], ESMA estimated costs for one third-country CSD notification would amount to ca. EUR 2 600 per notification. Assuming that 5 third-country CSDs would notified, the costs would be estimated around ca. EUR 13 000 for ESMA. This would be one-off cost that could potentially be covered by a notification fee to be paid by each third-country CSD. The introduction of the end-date for the grandfathering clause will mean that ESMA may adopt some recognition decisions, however this is a task that already lies with ESMA.
- *NCAs*: NCAs may be consulted when ESMA assesses an application for recognition by third-country CSDs which may marginally increase their operational costs; in addition, NCAs will have access to increased information regarding the activities of third-country CSDs which will help them to identify and monitor risks.

[461] Based on confidential information provided to DG FISMA services.

ANNEX 8: GRAPHS AND FIGURES

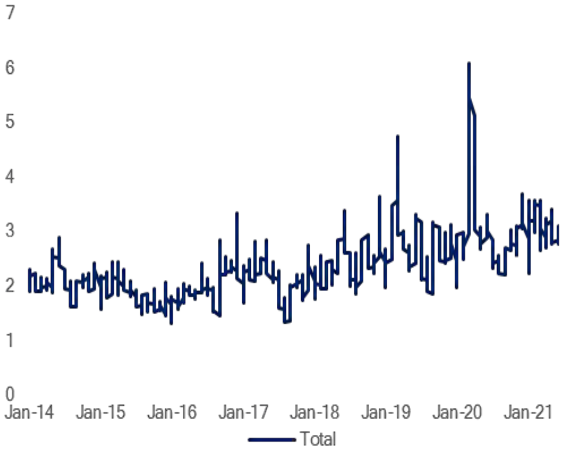
Figure I: Passporting of CSD services in the EU[462]

	EEA countries were passport is sought/obtained	**EEA countries where CSD is of substantial importance**
ATHEXCSD	1 (CY)	0
Lux CSD	3 (DK, FR, NL)	0
Clearstream Banking AG	8 (AT, FI, FR, IE, LU, NL, ES and LI).	6 (BE, IE, LI, LU, SK, SI)
Clearstream Banking SA (ICSD)	28 (AT, BG, CY, CZ, DK, EE, FI, FR, DE, EL, HU, IS, IE, LV, LT, MT, NL, NO. PL, PT, RO, SK, SI, ES, SE ; process ongoing in BE, HR, IT)	19 (AT, BG, HR, CY, EE, FI, DE, IS, IE, LV, LI, LT, MT, NL, NO, PT, RO, SK, SI)
Euroclear Bank (ICSD)	27 (AT, BG, HR, CY, CZ, DK, EE, FI, FR, DE, EL, HU, IS, IE, IT, LV, LT, LU, MT, NL, PL, PT, RO, SK, SI, ES, SE)	23 (AT, BG, HR, CY, DK, EE, FI, FR, DE, EL, IS, IE, LV, LI, LT, LU, MT, NL, NO, PT, RO, SK, SI)
Euroclear Belgium	25 (AT, BG, CY, CZ, DK, EE, FI, FR, DE, EL, HU, IE, IT, LV, LT, LU, MT, NL, PL, PT, RO, SK, SI, ES, SE)	0
Euroclear France	27 (AT, BE, BG, CY, CZ, DK, EE, FI, DE, EL, HU, IE, IT, LV, LT, LU, MT, NL, PT, RO, SK, SI, ES, SE; process ongoing in IS, LI, PL)	3 (BE, IE, NL)
Euroclear Netherlands	26 (AT, BE, BG, CY, CZ, DE, DK, EE, FI, FR, EL, HU, IE, IT, LU, LV, LT, MT, PT, RO, SK, SI, ES, SE; process ongoing in IS, LI)	0
Euroclear Sweden	4 (DE, DK, FR, FI)	3 (DK, FI, MT)
Euroclear Finland	4 (BE, DK, DE, SE)	0
Iberclear Spain	1 (DE)	1 (IE)
ID2S	1 (IE)	0
KDD Slovenia	1 (BG)	0
KDPW Poland	3 (CY, LU, NL)	0
Nasdaq Latvia	3 (EE, IS, LT)	3 (EE, IS, LT)
OeKB CSD Austria	1 (DE)	1 (LI)
Monte Titoli	7 (AT, DE, EL, FR, IE, LU, MT, NL)	1 (IE)
VP Securities A/S Denmark	1 (process ongoing in MT)	0

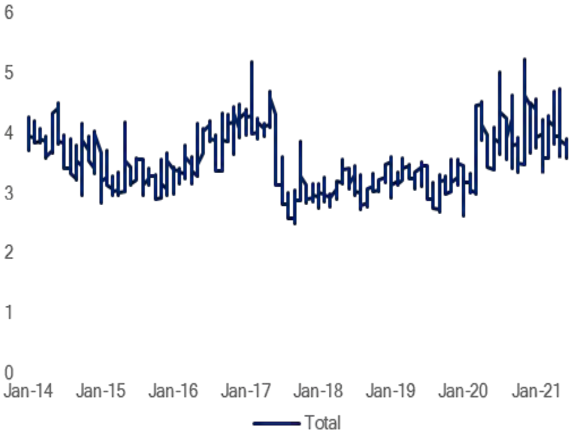
Note: The table shows the extent of cross-border service provision by individual CSDs (left column) and in what Member States a given CSD is systemically important (right column). Although a growing number of CSDs provide service on a cross-border basis (15 CSDs have obtained or applied for a passport in at least one host Member State), only a small number has expanded their offering in non-domestic markets sufficiently to become systemically important (9). Source: ESMA CSD Register.

[462] ESMA CSD Register (see note 26).

<u>Figure II: Settlement efficiency on EU capital markets (Total and separately for debt and equity instrument)</u>

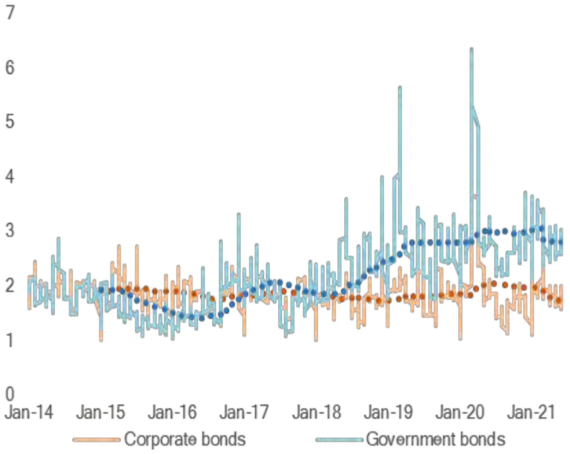


Note: Share of failed settlement instructions in the EEA, in % of value, one-week moving average.
Sources: NCAs, ESMA.

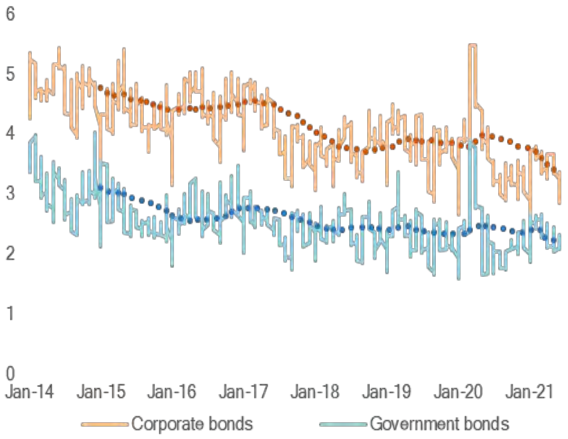


Note: Share of failed settlement instructions in the EEA, in % of total number of instructions, one-week moving average.
Sources: NCAs, ESMA.

Note: The graphs show the evolution of settlement fails for all in-scope financial instruments (both equity and debt) in terms of % of turnover (left graph) and total number of instructions (right graph). The left graph shows that following a spike in spring 2020 settlement fails returned to pre-crisis levels, while the values in the right hand graph remained elevated, indicating potentially that a higher number of small-value transactions fail.

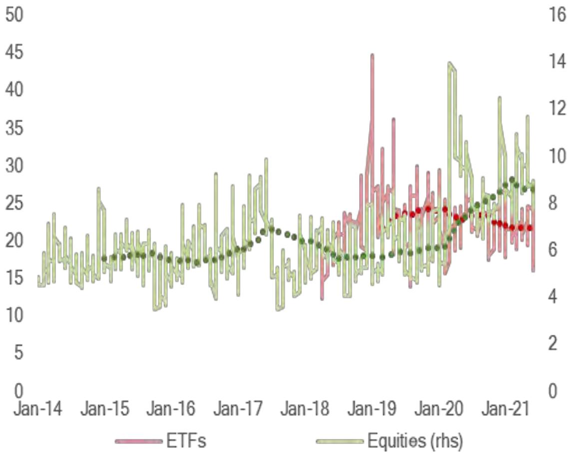


Note: Share of failed settlement instructions in the EEA, in % of value, one-week moving averages. Dotted lines represent one-year moving averages.
Sources: NCAs, ESMA.

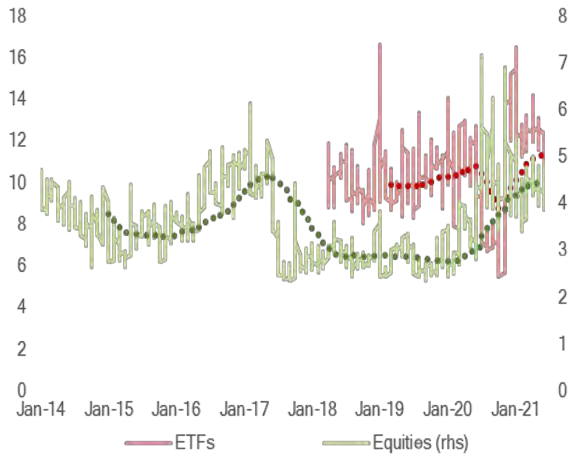


Note: Share of failed settlement instructions in the EEA, in % of total number of instructions, one-week moving averages. Dotted lines represent one-year moving averages.
Sources: NCAs, ESMA.

Note: The graphs show the evolution of settlement fails for debt instruments (corporate and government bonds) in terms of % of turnover (left graph) and total number of transactions (right graph). The graphs show a stable settlement fail rate for corporate bonds in terms of value (left graph), while the number of failing corporate bonds instructions continues to fall, indicating an increasing number of high value bond transactions failing. In the case of government bonds this evolution is even more pronounced.



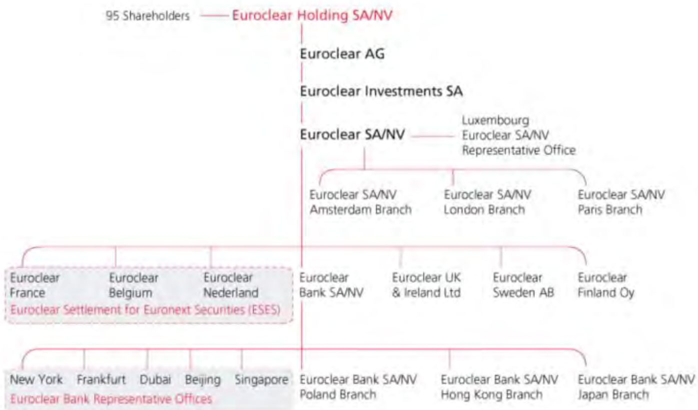
Note: Share of failed settlement instructions in the EEA, in % of value, one-week moving averages. Dotted lines represent one-year moving averages. Uneven ETF data reporting across CSDs before 2021.
Sources: NCAs, ESMA.



Note: Share of failed settlement instructions in the EEA, in % of total number of instructions, one-week moving averages. Dotted lines represent one-year moving averages. Uneven ETF data reporting across CSDs before 2021.
Sources: NCAs, ESMA.

Note: The graphs show the evolution of settlement fails for equity instruments (exchange-traded funds (ETFs) and equities) in terms of % of turnover (left graph) and total number of transactions (right graph). The graphs show a stable settlement fail rate for ETFs in terms of value and number of transactions. The values for equities show that most recently both the value and number of failed equities transactions has increased.

Figure III[463]: Euroclear governance structure



Note: Euroclear is one of the biggest groups of CSDs in the EU. Euroclear SA is the parent company for six domestic CSDs and an ICSD, Euroclear Bank. Risk management is carried out at both group level and at the level of each daughter-company (CSD) to identify local risks. Three domestic CSDs (France, Belgium and the Netherlands) use a common settlement platform (ESES).

Figure IV[464]: Estimates of the expected increase in mandatory buy-in bid/offer spread

463 https://www.euroclear.com/about/en/ourgovernancestructure.html
464 Based on confidential information provided to DG FISMA services.

MTS EGB 10Y B/O spreads (average 2020 excluding March/April)		initial estimated increase in B/O spread
Core markets	1.5bp	50%
Non-core markets	2.5bp	+100% - off
Large markets (core/non-core)	1.7bp	50%
Small core markets	1.5bp	off
Small non-core markets	3.5bp	off

Note: The table shows the estimated[465] impact of mandatory buy-in (MBI) on European government bonds (EGB) with a 10-year maturity in basis points (bp) for a financial institution. The pricing data is taken from an inter-dealer electronic platform (MTS). Taking account current liquidity conditions (Spring 2021), the application of MBI to EGBs would lead to a 50% to 100% increase in bid-offer spread (B/O spread) depending on the size and the status of the markets to a complete drop of activity (off).

ANNEX 9: DESCRIPTION OF THE BUY-IN PROCESS

When the seller fails to deliver the securities within a predetermined extension period following the ISD, a mandatory buy-in process is set in motion. A buy-in provides the buyer of securities – in case of a settlement fail – with the right to obtain the securities elsewhere, cancel the original transaction and settle the costs of the buy-in, as well as any price difference, with the original seller.

The extension period, following which the mandatory buy-in must be triggered, varies depending on the type of security and its liquidity[466], as does the timeframe during which the execution of the buy-in must be completed. Once the extension period has ended, a buy-in agent must be appointed in order to execute the buy-in. This buy-in agent must act in accordance with best execution requirements when executing the buy-in. If the buy-in process fails or where a buy-in is not possible, the failing seller is required to pay cash compensation to the buyer. The buyer can, however, prior to this cash compensation, defer the buy-in for an additional timeframe, which is equal to the timeframe originally provided for the completion of the buy-in process.

In addition to bearing the costs related to the buy-in, the failing seller will also be required to pay the price difference between the buy-in price and the price originally agreed at the time of the transaction, if the latter is lower than the price effectively paid at the buy-in execution. On the other hand, if the original price agreed at the time of the

465 Initial year and without taking into account the buy-in agent nor the increase in funding costs.

466 Four business days for financial instruments other than those traded on an SME growth market. Based on asset type and liquidity of the financial instruments concerned, the extension period may be increased from four business days up to a maximum of seven business days where a shorter extension period would affect the smooth and orderly functioning of the financial markets concerned. For operations composed of several transactions including securities repurchase or lending agreements, the buy-in process referred to in paragraph 3 shall not apply where the timeframe of those operations is sufficiently short and renders the buy-in process ineffective. It should be noted that such exemptions mentioned above shall not apply in relation to transactions for shares where those transactions are cleared by a CCP. Finally, for financial instruments traded on an SME growth market the extension period is of 15 business days (unless the SME growth market decides to apply a shorter period).

original transaction is higher than the price effectively paid at the buy-in execution, the price difference will be "deemed paid", which means that the failing seller will not be entitled to payment of the difference by the buyer.