AUTORITÉ DES MARCHÉS FINANCIERS

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Speech by Robert Ophèle, AMF Chairman - ECSDA Annual Conference - 20 November 2019 in Brussels

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First, let me thank ECSDA for giving me the opportunity to share with the industry and fellow regulators some thoughts about the future of the securities depository industry. We all know just how key the post-trade industry is for the efficiency and robustness of our capital markets. Five years after the entry into force of its funding European regulation, CSDR, and at the start of a new European mandate putting Capital Market Union high on its agenda, it is time to start taking stock of its first results.

As a matter of fact, CSDR required a review of the regulation, actually by 18 September 2019, assessing in particular whether there are substantive barriers to competition, which are not sufficiently addressed, and whether there is a need for further measures to limit the impact on taxpayers of the failure of CSDs. This review has not yet started and one could argue that we should wait until the full implementation of the regulation in order to have a fully fledged assessment. I don’t share this view, we need a review next year but a targeted review.

- First, I observe that the regulation it-self has provided for a review well before the application of the book-entry form requirements for transferable securities, which will only take place by January 2023.
- Second, the first five years have brought some deficiencies in the regulatory framework to light, which will need to be addressed in order to further improve the settlement

efficiency within the EU and the strengthening of the capital markets union.

More than five years after CSDR's entry into force, it is fair to recognise that we are still far from having achieved our goals. While it is partly due to the late adoption of Level 2 implementation measures, the fact that less than half of EU CSDs have been authorised under CSDR is striking and this is not satisfactory. Furthermore, I note that:

- the industry is still expecting answers on some technical issues, for example on the order of settlement and the associated liability in case this order is not followed;
- the enforcement of settlement discipline rules is about to be somewhat delayed in order to accommodate some operational difficulties (change in the Swift standards and implementation of an adapted penalty mechanism by T2S).

Today I would like to focus more specifically on two topics in the perspective of this CSDR review: on issues related to cross-border activities and issues related to technological innovations.

One of the main objectives of CSDR was to develop cross-border activities; let me quote Recital 4 of this regulation: "the settlement markets in the Union remain fragmented across national borders and cross-border settlement remains more costly, due to different national rules regulating settlement and the activities of CSDs and limited competition between CSDs … given the systemic relevance of CSDs, competition between them should be promoted so as to enable market participants a choice of provider and reduce reliance on any one infrastructure provider."

With thirty CSDs in the European Economic Area and a very strong attachment to national CSDs, the challenge of CSDR and the challenge of the CMU are indeed most demanding. To some extent, Brexit with the problems raised by the settlement of Irish securities on a future third country CSD has emphasised the issue's highly sensitive nature.

Of course, it should be noted that there are fewer barriers to the cross-border provision of settlement services and processes than there were 15 years ago. This progress has been enabled by several factors including, in particular:

- legal instruments such as MiFID, MiFIR or EMIR;
- the operational and legal harmonisation work carried out in the T2S context, that has dramatically accelerated harmonisation and contributed to the removal of barriers; and

- market initiatives such as ISO messaging standards or Market Standards for Corporate Actions Processing.

Taken as a whole, these factors have catalysed harmonisation in post-trade activities.

However, despite the removal of several barriers, cross-border settlement volumes are still disproportionately low when compared with domestic settlement. While T2S statistics do not provide a full picture of cross-CSD settlements, their very low level, below 1 % of the total settled, is a clear indication of the remaining barriers to cross-border settlement. Some of them are institutional (for example the lack of harmonisation in withholding tax relief procedures) and have been already identified in the European Post Trade Forum (EPTF) report from 2017; others are explained by the slow opening of domestic organisations to cross-border trade.

At this juncture, I am inclined to think that CSDR has not, or has not yet, fostered cross-border activities of CSDs. Indeed, it is noticeable that the new cross-border regime implemented under CSDR sometimes lacks clarity and, to a large extent, creates additional layers of complexity where it should in fact smoothen the processes for the cross-border provision of services. The grandfathering of existing cross-border activities, the interactions between home and host authorities, the determination of the relevant laws to be assessed by CSDs - law of the issuer and/or law(s) on issuance - many clarifications regarding the cross boarder provision of CSD services were, and some are still, needed.

In order to ensure that CSDs have appropriate tools to embrace a fully European activity, it would seem necessary to rethink the CSDR passporting regime in order to clarify and simplify it. The upcoming CSDR review could be an appropriate tool in order to tackle this issue.

Finally, I believe that technological developments could be possible facilitators for cross-border detention and issuance of securities, thanks to the additional automation they could allow. This leads us to my second topic, the influence of technological developments. We need to ensure that the current legal framework can be appropriately adapted to take them into account. This is particularly true regarding the field of Distributed Ledger Technology and security tokens.

Although DLT may aggravate some risks such as cyber-risks and raise new supervisory challenges, it could also bring obvious benefits to the post-trade environment such as faster settlement and confirmation processes and easier reporting structures.

It could also aim, in the medium term, to reduce costs and speed some processes up that are too manual and too costly. It is therefore important to encourage and facilitate its development, starting with certain market segments where scalability is not an issue and where financial stability concerns are not significant. This, however, is impossible without a clearly defined legal and regulatory framework.

From a general point of view, the EU way of regulating post-trading activities is at odds with DLT since it is silo-based approach (custody is regulated in AIFMD/UCITS Directive, settlement in CSDR and in the Settlement Finality Directive, clearing and reporting in EMIR and SFTR) whereas DLT integrates the whole market chain.

Moreover, the international regulatory approach, adopted more than 10 years ago by the FSB and CPMI-IOSCO has aimed at strengthening surveillance of operations implemented by centralised infrastructures (such as CCPs, CSDs or TRs) and to attract flows of transactions to those centralised entities, whereas DLT, on the contrary, relies on a decentralised organisation. The existing legal environment does not facilitate the use of DLT and, in some cases, it even prevents experimentation.

Based on analysis recently carried out by the French AMF, I note for example that the EU legal environment regarding finality and settlement of transactions creates strong impediments to the development of security tokens listed on trading platforms, which characterise financial instruments. Such impediments are, for example:

- The obligation to identify a manager of the blockchain acting as a securities settlement system;
- The requirement that a credit institution or an investment firm intermediates the access to the securities settlement system for individuals;
- The fact that ownership rights are acknowledged at custodian level and not simply on the basis of the registration of the security tokens on a blockchain; and
- The obligation to settle transactions in cash, central bank money or commercial bank money, which is not the case on blockchains that would need a dedicated stable coin in order to settle operations.

Legal and regulatory initiatives have recently been introduced in France covering security tokens. However, without a harmonised legal framework at EU level such kind of initiative cannot efficiently tackle the issues I have just mentioned, all of which stem from EU legislation (in particular the finality directive and CSDR). In that respect, we should recognise

that Switzerland is rapidly developing a strong ecosystem based on a legal and regulatory framework adapted to security tokens. The EU should not fall behind.

It is therefore important that the European Commission deals with these topics and, here again, the CSDR review could offer the opportunity to treat part of them with a specific chapter on new technologies. However, the work on these matters should be much wider and ensure consistency of the proposed framework across all relevant EU legislations.

To conclude, I think that while we need to finalise the implementation of CSDR to fully reap the benefit of this new regulation, especially regarding settlement discipline, we should not postpone the CSDR review. It is an opportunity to adjust the framework of cross border activities and to consider ways of incorporating the implementation of new technologies in the settlement process.

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