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Discours de Robert Ophèle, président de l'AMF - Forum mondial des Dépositaires Centraux (World Forum of CSDs - WFC) organisé par l'ECSDA : «Contribution des Dépositaires Centraux de Titres aux économies locales et mondiale» - 30 mai 2022 (en anglais uniquement)

Seul le prononcé fait foi

Many thanks to ECSDA for inviting me, at the end of my tenure as the head of the French AMF, to share some thoughts with you on how CSDs contribute to the smooth functioning of financial markets.

CSDs are actually one of the little-known faces of financial markets. While IPOs, trading or repos are the sunlit and better known faces of financial markets and where central clearing has drawn the utmost attention of public authorities due to their key role for both concentrating and globally reducing financial stability risks, CSD matters remain rather confidential and are considered a field for experts.

However, CSDs do play a crucial role in the development and orderly functioning of capital markets and are essential for the timely posting or delivery of collateral for payments and market operations:

- for the primary market, by centralising the initial recording of any newly issued security, they are the undisputed trusted third parties (a form of notary service).

- for the secondary market, by operating the infrastructure that enables the completion of a securities transaction, they insure the delivery-versus-payment or DVP mechanism that safeguards the whole process (settlement).
- by ensuring the integrity of the issue throughout a security's entire life cycle, they provide all market participants with protection.
- in addition, ancillary services provided by CSDs, such as collateral management services or administration of corporate actions and redemptions, contribute to enhancing the safety and efficiency of the financial markets.

CSDs are also key facilitators of market globalisation, integrating local financial markets into a worldwide grid by establishing links between CSDs that facilitates cross border access to securities.

Nevertheless, as chair of an EU financial markets Authority, participating in the World Forum of CSDs does make me feel rather uncomfortable. In most jurisdictions you have just one single CSD, playing both the role of issuer CSD for the local issuers and of investor CSD vis-à-vis third country markets. In the EU, despite aiming at developing a single financial market and despite the largest part of the Union sharing a single currency, the Euro, almost every Member State has its own local CSD, making the EU landscape overly complex and costly - in short inefficient.

When I joined the AMF five years ago coming from the French central bank, I was firmly convinced that improving the post-trading structure of the EU was both necessary and possible; it was in that perspective that I was appointed chair of ESMA's Post-trading standing Committee. This was necessary in order to build-up efficient financial markets in the EU, in short to deliver the so-called Capital Markets Union. It appeared possible since at the time we had the conjunction of several favourable factors.

And indeed, at the time, Target 2 Securities was just being completed, finally, with the fourth wave of migration successfully managed in September 2017.

Also, the European Post Trade Forum, the EPTF, was in the process of delivering a thorough review and update of the Giovannini barriers, as they were then known as, and the European Commission promptly launched a consultation on ways of dismantling these remaining barriers; by the way, the AMF response to this consultation can be found on our website.

Lastly, the new CSD Regulation was just starting to be implemented and we were all working hard to authorize CSDs under the new regulation. Actually, this has taken ages since it was just a few weeks ago that the Croatian and the Norwegian CSD were authorized. One of the main ambitions of this regulation was to develop cross-border services since - I quote recital number 15 - *" Whereas 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 the internal market"*. Therefore, according to article 23 of CSDR *"An authorized CSD may provide services referred to in the Annex within the territory of the Union, including through setting up a branch, provided that those services are covered by the authorization."*

Five year later, overall progress is still rather disappointing.

While four financial groups, currently Euroclear, Deutsche Börse, Euronext and Nasdaq account for the bulk of CSD activities, there are still, if I am not mistaken, 28 CSDs or ICSDs in operation in the EEA according to the ESMA register.

The daily average volume of cross-CSD settlement transactions in T2S, although on the increase, remains negligible: it represented less than 1 percent of all settlement volumes in T2S in 2020.

Admittedly, many passports have been granted under CSDR and in some cases some CSDs have requested and obtained 24 passports, i.e. they span almost the whole EEA area. But assets under deposit, as per data collected by ESMA, centrally maintained within the EEA CSDs do not reflect an expansion of cross-border activities. If we look at the 8 passports granted to EEA CSDs by the AMF, the respective annual value of financial instruments issued by French issuers and registered by those EEA CSDs remains somewhat slight (6% in 2021). Then when you look at transactions, only the two ICSDs have a significant market share, mainly for short-term debt securities. Even when looked at from another angle, the picture is broadly similar, assets of non-French issuers registered in the French CSD constituted 7% of the total.

When the ECB floated the European Distribution of Debt Instruments (EDDI) initiative, most responses to the consultation and more specifically CSDs' responses as developed by ECSDA it-self were not in support. The initiative was buried and April's ECB report on financial integration in the Euro area once again highlights how high transaction costs for cross-border transactions are fostering inefficient home bias especially for non-government bonds and it advocates harmonization of the debt issuance process and, at a minimum, reinforcing the already crowded network of links between CSDs.

The central maintenance in securities accounts of financial instruments issued by issuers from the respective home Member States currently remains highly concentrated within the respective historic CSDs, except for the ICSDs and to a certain extent, Nasdaq CSD since the latter operates as a regional CSD for Lithuania, Latvia, Estonia and Iceland. Competition remains rather weak, the post-trade costs remain high and settlement fails remain consistently higher in Europe than in other major financial markets, and as such, this can be seen as a sign of the system's relative inefficiency

The Penalty Regime finally entered into force last February and it would be premature to draw preliminary lessons; we will see in due course if it really incentivises settlement on the intended settlement date and the settlement of failed transactions in a timely manner within the EU.

Of course, the application of such unprecedented and complex regulation did not run without any issues or challenges in the course of the initial months. We observed that some CSDs encountered difficulties with the implementation of a smooth mechanism to achieve CSDR's objectives.

Several market players flagged gaps and defects identified during the penalty reporting process relating to last February's settlement instructions; among others, at the AMF we received adverse feedback regarding late penalty reporting, incorrect detection of penalties, penalties reported with incorrect relevant settlement references, penalties involving incorrect amounts.

Today, a large part of the challenges has been overcome. To give you an idea, figures for April for the French CSD are as follows: we had a 3% settlement fail rate in terms of volume and almost 4% in value with an average duration of settlement fails of 1.8 day and penalties totalling 23 million euro.

Actually the main changes proposed by the EC in the CSDR Refit proposal regarding cash penalties are not very substantive. They cover:

- some clarifications regarding the scope: cash penalties should not apply in situations where a settlement fail is caused by factors not attributable to the participants in the transaction or where a transaction does not involve two counterparties.

- The delegated act specifying the parameters for the calculation of a deterrent and proportionate level of the cash penalties shall take into account the effect that low or negative interest rates could have on the incentives of counterparties and fails. Since negative interest rates are likely to be behind us fairly soon, this would not be a game changer.

I have just mentioned CSDR Refit. Actually, once again, the Commission has put the development of cross-border settlement services at the core of its CMU Action Plan and it is supposed to be the main purpose of the CSDR Review.

While it is obviously important to adapt the settlement discipline framework and alleviate, I quote, the *"disproportionate burdens and costs related to settlement discipline"*, the main purpose of the review should be the improvement in cross-border services.

At this juncture, the buy-in regime appears to be somewhat of a red herring. While the option to remove the framework from CSDR was officially disregarded by the European Commission, the proposed approach appears to be extremely prudent. According to the so-called "Two-step approach", depending on how settlement efficiency evolves in the EU after cash penalties have been applied, the Commission may adopt an implementing act deciding to apply mandatory buy-ins to certain financial instruments or categories of transactions, based on the number and value of settlement fails. And in that case, there will still be a possibility for the EC, following a non-public recommendation by ESMA, to suspend the buy-in mechanism for specific categories of financial instruments where necessary to avoid or address a serious threat to financial stability or to the orderly functioning of financial markets in the Union. It is fair to say that a mandatory buy-in is no longer in the pipe.

More important are the provisions which could foster the integration and reduce fragmentation, with two important issues flagged: the passporting regime and the cooperation between authorities on the one hand, the scope of ancilliary services on the other.

In line with many other financial services legislation, passports would become automatic, meaning that host authorities would no longer be able to refuse a CSD's application to provide services cross border and would just be notified by the home authority. By drastically simplifying passporting requirements, issuers could benefit from a larger choice, this would foster competition and integration of the EEA capital markets. From this perspective and with the host Authorities no longer having within their remit their usual supervisory tools for passported activities, there would be an obvious need to organize supervisory cooperation among the different relevant authorities. As usual, and in the EU currently, instead of drawing the obvious conclusion that if a financial infrastructure is developing an activity cross-border and has a European footprint, it should no longer be supervised locally but at a European level by a single supervisor, the proposed institutional supervisory calibrationwould be based on supervisory colleges, passporting colleges and group level colleges. These colleges would allow for a structured exchange of information, for coordination of supervisory actions, with a focus on issues relating to the provision of cross-border services for passporting colleges, and to outsourcing and structure changes for group colleges.

While these colleges could ensure more supervisory convergence, I fear that it would be a costly and relatively inefficient way of reducing divergences. Let us see it as a first step in the right direction.

The Commission has also rightly highlighted the *"Disproportionate requirements to provide banking type ancillary services"*. Today, non-banking CSDs have only two options to access banking services: either using a limited purpose credit institution, so limited that none has been set up due to the lack of a business case, or using a regular commercial bank, however the thresholds are very low and deemed inappropriate by most CSDs. This situation prevents certain CSDs from proposing services in foreign currencies and impedes their business development. Solutions were proposed in the July 2021 ESMA report on the provision of banking-type ancilliary services and have been taken on board. Basically, the threshold below which a CSD may access commercial bank money will no longer be set by CSDR, but will be defined by the EBA in a level 2 text and banking CSDs would be allowed to offer banking services to non-banking CSDs, in or outside the group. It could clearly accelerate the transformation of the CSD landscape in the EEA.

I cannot close this contribution to your conference without a few words on the Distibuted Ledger Technology or DLT Pilot Regime. First because it is to some extent linked to the provision of banking services:will they use tokenized commercial money or a central bank digital currency?

However, more fundamentally because at some point it could be a game changer for the CSD industry.

For memory's sake, the DLT Pilot regime creates, starting early next year, a regulatory sandbox that would allow certain infrastructures, such as a DLT central securities depository and DLT trading and settlement systems, to implement and operate a settlement system for financial securities to be registered using distributed ledger technology, while benefiting from certain exemptions to mandatory constraints imposed by CSDR. The operation of a settlement system for financial instruments registered using DLT quite obviously remains subject to the obligation to be authorised as a CSD (or at least as an MTF for the operation of DLT TSS).

Even if the scope of the regulation remains narrow, one threshold of securities to be settled on the infrastructures are quite low at EUR 6 billion. And even if we all know that some scalability issues have yet to be solved, rationale is to allow the development of technological innovations regarding the negotiation and settlement of financial securities. The assumption in this regard is that the use of DLT in post-trade activities should allow real time settlement and significantly reduce counterparty risk. Moreover, it is fair to say that in the current European landscape, it would be impossible to shorten the settlement cycle from T+2 to T+1, the way DTCC intends to implement this. To my knowledge, some major market participants are already working on projects within the framework of the DLT Pilot Regime.

So the CSD industry in Europe is moving - it is moving slowly but surely, which is most reassuring for such a systemic link in the financial market's value chain.

Thank you for your attention.

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