



## **Capital Markets Union: the European Commission works on dismantling post-trade barriers. February 2018.**

As part of the Action Plan on Building a Capital Markets Union, on 23 August 2017, the European Commission (EC) launched a public consultation with the aim of gathering opinions about the current state of post-trade markets, the main trends and challenges faced by post-trade services (e.g. clearing, settlement and collateral management) providers and their users, the existence and scale of remaining or new barriers, the risks associated with such barriers and the best ways to address them, including the use of FinTech. The consultation period ended on 15 November and the EC is expected to publish the strategy to be followed shortly.

In 2015, the EC announced its interest in resuming the work on post-trade barriers initiated by the Giovannini Group, set up to advise the EC on financial integration in the European Union (EU) and the efficiency of euro-denominated financial markets, which in 2001 had identified a series of post-trade barriers referred to as the "*Giovannini barriers*". In 2016, the EC established an independent expert group – the European Post-Trade Forum (EPTF) – which in May 2017 published a report on post-trade in Europe and progress in dismantling barriers. The public consultation gathers, *inter alia*, opinions on part of the conclusions of the report and aims to identify other possible barriers and to seek out solutions.

### **Background**

Since identification of the "*Giovannini barriers*", a series of legislative changes have been undertaken affecting the post-trade environment. The European Market Infrastructure Regulation (EMIR)<sup>1</sup> introduced mandatory clearing for OTC derivatives through central counterparties (CCPs), reporting to trade repositories authorised or recognised by ESMA – European Securities and Markets Authority – of all derivative contracts traded by financial and non-financial counterparties, the use of risk mitigation techniques when derivative contracts are not cleared through a CCP, as well as a unified regime for CCPs and trade repositories. The Central Securities Depositories Regulation (CSDR)<sup>2</sup> has increased the safety and efficiency of the settlement service, mainly for cross-border transactions. The Securities Financing Transaction Regulation (SFTTR)<sup>3</sup> has increased the transparency of certain financial transactions (including the reuse of collateral) and helped investors have a better understanding of the risks.

Furthermore, technological innovations such as the *Target2 Securities system* (T2S)<sup>4</sup> have improved the post-trade environment.

### **The Public Consultation**

The Consultation is divided into two parts. The first deals with EU and global trends, new technologies and competition in post-trade, and the second addresses barriers that persist in post-trade and solutions to remove them.

## 1. The first part of the public consultation consists of five sections:

a) *The main trends in post-trade.* The EPTF expects in the near future: (i) increased automation at all levels of the custody chain; (ii) new technological developments such as distributed ledger technology (DLT) being increasingly used in post-trade; (iii) more cross-border issuance of securities driven by the CSDR-based right for issuers to use any Central Securities Depository (CSD) in the EU; (iv) more trading in equities taking place on regulated trading venues due to trading obligations under MiFIR/MiFID II<sup>5</sup>; (v) improved shareholder relations and better opportunities for shareholders to exercise their rights cross-border, driven by the review of the Shareholder Rights Directive and (vi) a shift of issuances to CSDs that participate in the T2S platform. The aim is to identify the most relevant trends, which ones will have most impact in the future, the nature of this impact (positive, negative or mixed) and whether there are any other trends in addition to those listed.

b) *Technological developments and their implications.* The aim is to calibrate the importance for post-trade of the possible benefits of the DLT (such as real-time execution of post-trade functions and lowered costs), as well as its possible risks (such as higher operational risks and higher legal risks). The consultation also asked for proposals as to how post-trade legislation could be more technology neutral and it aims to assess whether the existing legal environment facilitates, inhibits or is neutral for technological developments.

c) *Financial stability.* It aims to identify what post-trade areas are more prone to systemic risk, what are the drivers of said risk and how to address this.

d) *The international dimension and competition.* The trends driving the development of post-trade services globally also affect EU markets. Although there are harmonised areas, others, such as settlement and trade reporting, are not harmonised. The aim is to identify the main international trends (harmonisation or lack of harmonisation and growing importance of collateral in international financial markets, etc.), the areas that would benefit from more international coherence (clearing, settlement, reporting, risk mitigation tools and techniques) and what would make EU markets more attractive internationally (removal of legal, market or operational barriers or other measures). Within the EU, the aim is to identify which areas would benefit from more consolidation and which would benefit from more competition.

e) *Future strategy.* The aim is to identify what EU post-trade markets should look like 5 or 10 years from now and what are the main challenges to deliver on this vision (fragmentation, lack of harmonisation, insufficient competition, lack of consolidation, lack of international competitiveness, need for more regulatory coherence internationally or other issues relating to financial stability).

## 2. The second part of the public consultation addresses post-trade barriers:

The EPTF report indicates that five Giovannini barriers have been dismantled: a) need for multiple infrastructure memberships; b) practical impediments to access to national clearing and settlement systems; c) absence of intra-day settlement finality in CSD; d) national differences in settlement periods; and e) national differences in operating hours/settlement deadlines. Others remain and new barriers have arisen. In total, the EPTF identified 12 barriers and five issues to be closely monitored to ensure new barriers do not emerge (the EPTF “watchlist”). The 12 identified barriers are as follows:

*Barrier 1. Fragmented corporate actions and general meeting processes.* Corporate actions (dividends, mergers and acquisition, etc.) often require authorisation by the shareholders and the holding of general meetings. National differences in rules governing operational processing result in higher costs and operational risks for shareholders to exercise their rights. The EPTF lists this barrier as one of the top five priorities and proposes industry actions as well as Commission action to develop implementing acts for the Shareholder Rights Directive.

*Barrier 2. Lack of convergence and harmonisation in information messaging standards.* National differences in

information technology and interfaces used by providers of clearing and settlement increase costs and the risk of errors. The solutions proposed include digitalisation, harmonisation or interoperability and standardisation. The EPTF suggests the creation of a (Regulatory) Reporting Market Practice Group to facilitate the reporting market practice.

*Barrier 3. Lack of harmonisation and standardisation of exchange traded funds (ETF) processes.* The ETF market in Europe is restrained by legal obstacles and a high degree of fragmentation, in particular in the post-trade area, which hinders its development. The EPTF suggests implementation of already existing market standards and special treatment for ETFs in settlement discipline under CSDR.

*Barrier 4. Inconsistent application of asset segregation rules for securities accounts.*

*Barrier 5. Lack of harmonisation of registration and investor identification rules and processes.* The EPTF believes that this increases complexity and costs in a cross-border setting and leads to issuers choosing their CSDs.

*Barrier 6. Complexity of the post-trade reporting structure.* The lack of harmonised post-trade reporting requirements and mechanisms for applying requirements on a day-to-day basis increases costs for reporting entities, infrastructures and regulatory authorities, and in turn increases the complexity of data analysis. The EPTF therefore proposes harmonisation of the reporting structure and introduction of a mechanism to maintain it.

*Barrier 7. Unresolved issues regarding reference data and standardised identifiers.* The EPTF proposes an international agreement on access to all reference data identifiers in order to promote open access to this data or, where appropriate, at a reasonable cost, as US service providers treat it as a commercial business.

*Barrier 8. Uncertainty as to the legal soundness of risk mitigation techniques used by intermediaries.* The EPTF proposes a revision of the relevant EU legislation.

*Barrier 9. Deficiencies in the protection of client assets as a result of the fragmented EU legal framework for book-entry securities.* Legal uncertainty about the ownership rights of clients and end investors leads, on the one hand, to insufficient protection of client assets in the event of an intermediary's failure and, on the other, delays in returning securities to their owners in case of a shortfall. The EPTF proposes harmonised rules on ownership rights and on loss attribution in case of shortfalls.

*Barrier 10. Shortcomings of EU rules on finality.* The EPTF proposes revising the Settlement Finality Directive as, among other aspects, it caters for a limited number of scenarios, does not address delivery versus payment mechanisms and is not sufficiently tailored for central clearing.

*Barrier 11. Legal uncertainty as to ownership rights in book-entry securities and third-party effects of assignment of claims.*

*Barrier 12. Inefficient withholding tax collection procedures.* Tax refund mechanisms to avoid double taxation of cross-border investment are usually complex and costly.

Barriers 1, 2, 3, 6, 7, 8, 9 and 10 have not yet been addressed and therefore the aim is to see whether their definition, scope and solutions proposed by EPTF are adequate and well-founded.

With regard to Barrier 5, although the Transparency Directive and the Shareholder Rights Directive include shareholder identification requirements, any future policy work should look at interactions and possible synergies between these different EU requirements. The aim is to see whether there is evidence about situations in which this barrier has led to detrimental effects.

With regard to Barrier 12, as part of the Action Plan on Building a Capital Markets Union, the EC has

developed a code of conduct for simpler and more efficient withholding and tax refund procedures. Although the code is non-binding, it provides a solution to the problem. Further possible solutions are also being sought.

The consultation does not cover Barrier 4 as asset segregation requirements are addressed in several Directives and the Commission is working with ESMA to resolve possible inconsistencies. Similarly, the EC has already conducted a consultation on the situation highlighted in Barrier 11 and has announced a legislative proposal.

Finally, another aim is to identify other barriers not included in the report and to collect the opinion on the five issues included on the EPTF *“watchlist”*: a) national restrictions on the activity of primary dealers and market makers; b) obstacles to delivery versus payment settlement in foreign currencies at CSDs; c) issues regarding intraday credit to support settlement; d) insufficient collateral mobility and e) non-harmonised procedures to collect transaction taxes.

<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> Regulation (EU) 2015/2365, of the European Parliament and of the Council, of 25 November 2015, on transparency of securities financing transactions and of reuse.

<sup>4</sup> T2S is an important infrastructure project implemented by the Eurosystem. It aims to provide a single pan-European platform for facilitating centralised securities settlement in central bank money of securities transactions in euros or in other currencies. It aims to take advantage of the synergies with other Eurosystem facilities, in particular with the TARGET2 payment system.

<sup>5</sup> Regulation (EU) No 600/2014, of the European Parliament and of the Council, of 15 May 2014, on markets in financial instruments / Directive 2014/65/EU, of the European Parliament and of the Council, of 15 May 2014, on markets in financial instruments.

#### **Links of interest:**

[Public consultation of the European Commission on post-trade barriers \(includes link to responses authorised for publication\)](#)