Is the EU securities market structure adequate?

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A European securities market beyond T2S

The euro is celebrating its 20th anniversary this year. Over the past two decades we have seen significant progress towards creating an integrated European market for the single currency. Today, the single euro payments area (SEPA) facilitates retail transactions throughout the Continent, and TARGET2 enables monetary policy operations and interbank transactions in euro.

In addition to the free movement of cash, building a true domestic market also requires securities and collateral to be able to move safely and efficiently between countries in Europe. This idea has been driving our work in the area of financial market infrastructure and I am pleased to say that with TARGET2-Securtities (T2S), our integrated IT platform which settles securities against central bank money, we have come a long way. Our efforts have also fed into the European Commission's action plan to build an EU capital markets union (CMU).

In fact, T2S has been a breakthrough in securities settlement and has laid the foundations for the CMU. Since its launch in 2015 it has unified a number of operational and functional aspects in the participating markets. It has also acted as a catalyst for the market to review and ultimately harmonise a number of post-trade processes and practices. It has thus contributed to dismantling at least ten of the 15 barriers to efficient EU cross-border clearing and settlement identified by the 2001 Giovannini report, such as national differences in information technology, operating hours and settlement periods. T2S has also shown that close collaboration between stakeholders from both the public and the private sector is the best way to deliver tangible results. Its inclusive governance structure was instrumental in pushing the T2S harmonisation initiative forward.

Building on the harmonisation already achieved in the area of securities settlement, we are now shifting our focus to post-trade activities related to securities and collateral management in order to address the remaining fragmentation across Europe. This work is driven by collaboration with key stakeholders under the umbrella of the Eurosystem's Advisory Group on Market Infrastructures for Securities and Collateral (AMI-SeCo). The aim is to achieve harmonised business processes, market practices and communication for the major categories of financial instruments used in Europe, such as debt and equities. A single set of harmonisation standards, i.e. a single rulebook, will establish rules and processes for financial instruments, thereby creating a level playing field for European stakeholders. These standards will be based on ISO 20022 messages and, therefore, the market is invited to already start planning for ISO 20022 implementation.

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>>> The Eurosystem has also made a commitment to address the inefficiencies in its own processes for collateral management. Currently, the 19 national central banks in the euro area use individual local systems to manage eligible assets mobilised as collateral. We intend to replace them with a single Eurosystem Collateral Management System (ECMS) as of November 2022, based on harmonised processes. The ECMS will manage the assets used as collateral in Eurosystem credit operations for all jurisdictions. Counterparties, central securities depositories and triparty agents located in different countries will benefit from the same harmonised system.

Despite this remarkable progress, a true single euro securities area is not a given just yet. To bring it closer to reality, it is important to ensure that none of the stages in the lifecycle of a security – issuance, trading, clearing, settlement and asset servicing – are affected by where in the EU issuers and investors are located. For instance, today the issuance and distribution of securities still relies on fragmented legacy standards, structural constraints and complex national market practices. Reflecting on ways to ensure a more efficient pan-European issuance and distribution channel could support the needs of European issuers and EU institutions and also have a positive impact on the establishment of a domestic yield curve for the euro money market.

All in all, we are continuously working towards the vision for a single EU capital market where cash, securities and collateral move safely and efficiently across borders and thus contribute to a stronger euro. ●

Olivier Guersent

Director General for Financial Stability, Financial Services and Capital Markets Union, European Commission

CMU and the EU27 Securities Market Infrastructure

In 2014, President Juncker set the goal of having in place the building blocks for the Capital Markets Union by 2019. While several legislative actions await for co-legislators' adoption, five years later the Commission did deliver on all planned legislative and most of the non-legislative actions. The legislative proposals include a pan-European personal pension product (PEPP), ensuring true portability of personal pension rights, the SME listing package, making it easier for SMEs to raise capital on public markets, and measures to facilitate the cross-border distribution of investment funds.

At the time of writing this article, almost half of the legislative files that were planned have reached a political agreement; the remaining ones are in final negotiations with the co-legislators. The Commission expects the co-legislators to fast-track some negotiations, ensuring political agreement before the May elections. On top of this, the Commission has made progress on a large number of non-legislative actions (about 60 actions). Among those, there is an ambitious Venture Capital fund-of-funds programme to increase the size of VC funds in the EU and to encourage cross-border VC activity, as well as an EU strategy on supporting local and regional capital market developments. All of those building blocks contribute to deep and liquid, Union-wide capital markets.

However, regulatory reform is only one part of the required change. This is why, in addition to the legislative programme, the Capital Markets Union Action Plan and Mid-term review set out a number of non-legislative actions. These actions are important in their own right to boost investor confidence, strengthen key market infrastructure and open new funding channels. By the end-March, the Commission will report on >>>

>>> progress under the CMU project, including non-legislative actions in the areas of market infrastructure, distribution of retail investment products, drivers for institutional investment in equity and corporate finance for entrepreneurs and start-ups. They will contribute to deep and liquid capital markets.

Stimulating market-based funding, by creating the conditions for market infrastructure to develop safely, is among the CMU's main objectives. By strengthening the funding escalator, everyone, from sole entrepreneurs to SMEs, would benefit from greater availability of risk capital. Today's start-ups are the blue-chips of the future. At the same time, MiFID II/MiFIR and EMIR 2.0 ensure transparency and stability in our financial market structure all through the value chain, from trading to settlement. High-quality market infrastructure enables the CMU to unlock its potential in modern, ever more globalised, financial markets.

Better developed local capital markets will be able to reap full benefits from participation in the EU single market. Pursuing cross-border financial integration requires adequate market infrastructures, a strong regulatory environment and market participants ready for international business. With such foundations, the channels for cross-border listing and trade of securities may be broadened and connections among market infrastructures can be established. An integrated EU capital market should offer easy access both to the large pools of assets and investors at European level and to market financing at local level.

Following the departure of United Kingdom from the EU, the Capital Markets Union needs to protect its critical functions for the provision and supervision of capital market services by sustaining liquidity and limiting regional fragmentation. For example, new rules on central counterparties will ensure a more consistent and robust supervision in EU and third countries. European consumers, investors and businesses will also benefit from stronger and more integrated financial markets, thanks to the reform of the EU's supervisory architecture. Further steps will be needed to ensure that market infrastructure keeps up with growing transaction volumes, that information is accessible and comparable, that investor rights are protected and sufficiently harmonised and that there is a single point of entry into the EU for foreign financial service providers. The Commission will continue its efforts to establish a consolidated tape for post-trade data, which would allow a better understanding of the markets.

Looking forward, in a post-Brexit environment, the Commission aims to safeguard and to further improve accessibility to trading infrastructure for equity and non-equity, and where necessary, further streamline investor protection requirements. ●

Jochen Metzger

Director General, Directorate General Payments and Settlement Systems, Deutsche Bundesbank

New EU securities market structure? Look ahead, don't look back!

As crucial networks that underpin the EU economy securities markets have to be as resilient and efficient as possible. Regulation can contribute to reaching that goal. However, to be truly effective regulation has to be designed carefully and targeted precisely. Rushed regulatory measures can be counterproductive as they risk being misguided – especially in times of rapidly developing new technologies such as DLT and tokenisation.

"In EU securities markets regulation technology is the next frontier."

\- JOCHEN METZGER

To be clear, EU regulation enacted after the global financial crisis has strengthened securities markets: it increased transparency, it ensured stability, and it promoted cross-border harmonisation. In trading, MiFID II and MiFIR have increased transparency for investors and regulators. Similarly, EMIR is increasing the stability and the transparency of the crucial derivatives markets. Finally, CSDR is >>>

>>> enhancing the safety and efficiency of securities settlement infrastructures in the EU. But before rushing to design new regulation for those areas we should see how the securities market structure develops in light of these initiatives.

Both the successful Eurosystem platform T2S on the technical side and CSDR on the regulatory side act as strong catalysts for the transformation of market structures in the EU and thus drive needed cross-border harmonisation. These efforts for harmonisation are crucial because even if some Giovannini Barriers have been successfully dismantled in recent years others still persist according to the EPTF. Fragmented corporate actions and annual general meeting processes, and inefficient withholding tax procedures are just some of the remaining barriers identified by the EPTF. Member states, supported by the Commission, need to implement solutions to overcome this. However, I am optimistic that CSDR will act as a powerful driver of harmonisation in coming years.

The CSDR enables CSDs to provide issuance services across borders regardless of where the issuers are based. The combination of T2S and CSDR will create incentives for CSDs to establish a comprehensive link structure and thereby foster cross-border investment and settlement. The legal and technical improvements together create the prerequisites for issuers to be able to choose their issuer CSD independently of where they are based. The broad access to T2S provided by over 20 connected CSDs guarantees the settlement of securities against central bank money. Central banks, CSDs and regulators have thus created a highly efficient market (infra-) structure. However, adjustments on the part of CSDs and custodians need time to take full advantage of it.

Reasonable regulatory measures have enhanced the EU securities market structure in recent years. Now we should wait until they take full effect in the markets. Rather than target established market processes new smart securities market regulation should be aimed at emerging technologies such as tokenisation and DLT in order to bring the Capital Market Union into the age of the platform economy – technology is the next frontier in EU securities markets regulation. ●

Alexandra Hachmeister

Chief Regulatory Officer, Deutsche Börse Group

MiFID II – Reviving the success story

Winston Churchill once said: “Success is not final…” – Obviously, he did not have financial markets in mind back then. Nevertheless, this perfectly describes the evolution of market structure in the EU as MiFID II/MiFIR has fundamentally changed the rules of the game. Today, around 15 months after its application, our markets have become more stable and transparent, and are subject to a more harmonised set of rules. As a passionate proponent of the political objectives of MiFID II to ensure transparency, integrity and investor protection, this is a clear and hard-fought success – albeit not one we should rest on.

MiFID II was designed when the United Kingdom (UK) was still a member of the EU. The UK’s withdrawal is a severe setback on Europe’s path towards more integration and cooperation in financial markets over the past years. Here, we will have to find new modes of cooperation to maintain the close links between our markets. However, we should not compromise on our high regulatory standards, which have become a hallmark of the EU’s financial reforms after the crisis. Sustainable economic growth can only be achieved on the basis of financial stability.

Nonetheless, this is about much more than just dealing with the implications of Brexit. The evolution of markets in financial instruments needs to be integrated in our vision for the future of the EU’s financial markets, within a multipolar, rapidly changing and highly competitive world order. Hence, we should not only raise the question: Did MiFID II succeed in making financial markets more transparent and efficient? Rather, we need to draw our conclusions on the more fundamental question: Did MiFID II establish a regulatory environment that allows EU27 financial markets to deliver on the higher-ranking goals of a healthy, sovereign and globally competitive EU internal market?

Let us zoom into one of MiFID II’s main features: MiFID II has further unleashed competition in equity markets; the number of trading venues and systematic internalisers has climbed to heights never achieved before; hurdles for new entrants to this highly dynamic market are low. Investors avail of unprecedented levels of choice where, when and how to invest their money.

> *“Sustainable economic growth can only be achieved on the basis of financial stability.”*
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> \- ALEXANDRA HACHMEISTER

Interestingly, we can observe a growing disquiet with this development, and discussions arising on the side-effects for the orderly functioning of markets and thus on their ability to deliver on their overarching goals. To name just a few of these questions: How does the fragmentation of trading across 185 SIs, 126 RMs, 191 MTFs and 76 OTFs (for equity and non-equity) affect market quality in terms of stability, liquidity and diversity? How efficient is such a market structure in transforming relevant information into prices? How does this contribute to investors and companies re-gaining trust in financial markets?

I am very much looking forward to this Eurofi in Bucharest, as it will be critical to deepen our reflections to ensure that the upcoming legislative period at the EU level will lay the foundation for a globally competitive yet stable and resilient EU27 internal market for financial services. ●

Märten Ross

Deputy Secretary General for Financial Policy and External Relations, Ministry of Finance, Estonia

EU market structures still not resembling CMU

Does the EU27 have the appropriate market structure to support the implementation of the CMU?

Achieving the 'at-least-reasonably-well-functioning-CMU' has two dimensions: developing individual capital markets and then separately improving the cross-border pan-European element of it. The tendency is still that much of the market structures and policies are geared towards the first dimension and that is not necessarily supportive to well-functioning holistic CMU. This is not just about physical market structures, but more so about broader infrastructure, for example the legal framework for company restructurings or pension systems.

From general market structure point of view another question mark remains to be the persistent excessive role of the banking sector in financial intermediation. In particular, as its (increased) fragmentation remains a concern and probably limits the potential for cross-border financial activity in general. Therefore, it might be that such apparently distant policy topics as decreasing decisively bank-state doom-loop or solving NPL backlog could actually support also activation of the CMU. On the more positive side of this topic the line between the traditional banking market and capital market has become more blurred over the time as deposit taking institutions are entering in the FinTech area and providing capital in a different and new form.

Institutional setup more broadly is also not yet fully appropriate. Revising financial market supervision as a tool to facilitate common capital market remains pretty much a work in progress. And while still notable home bias could mirror the factual developing stage of the European single market and politics in general, it points also to the lack of sufficient integration for the efficient capital allocation.

And does it have the appropriate securities market infrastructures?

There are notable recent improvements in market infrastructures. Including in retail payments that is not irrelevant for the securities market functioning.

However, if there are probably not much problems with major wholesale markets, then the question of excessive costs of financial intermediation might still be there. CMU could function reasonably well only if it will remove obstacles for cross-border capital raising for SME segment by reducing transaction costs, advisory fees but also account management fees. Ideally the CMU should support also integration on retail markets.

But present requirements and market approach are still too restrictive for them. For example, regulations for the registry keeping for funds and securities may fit poorly into advances in technological development. And in so called soft infrastructure – including requirements on market analysis, compulsory data or LEI-code type innovations – regulatory costs seem to be quite restrictive. At least if implemented strongly.

What further improvements might be needed?

In many central elements of the market infrastructure things seem to be quite advanced for the CMU to function. Although even on T2S project one could ask for further flexibility including in supporting the processing of corporate actions, including tax and general meetings.

From regulatory environment side better readiness to absorb fintech-related innovations remains the area for improvement. Present framework tends to regulate too much 'old structures' and ability to absorb technological advances into the main single market remains work in progress. For example, securities' registry keeping regulation might still be 'no-technology-neutral' towards blockchain innovations.

"CMU could function well only if it will be able to reach out at least SME segment."

\- MÄRTEN ROSS

Further improvements are needed in the setup of European supervisory framework as well. While rushing into centralization would not help CMU, clever step-wise strategy to the European system facilitating inter alia stronger implementation of the single market regulation is needed. This is increasingly the case also for anti-money laundering area as the lack of trust in this area puts (in)visible breaks also to the proper and efficient cross-border functioning of the securities market. ●

Andrew Douglas

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Further harmonisation needed to deliver on full potential of EU capital markets

As early as 1999, it was hoped that the introduction of the euro would naturally lead to a convergence among Europe's capital market and post-trade market infrastructures but it's fair to say that progress was a lot slower than anticipated. This led to the creation of the Giovannini Group whose mission was to identify barriers (later known as the Giovannini barriers) preventing efficient cross-border clearing and settlement in the EU. Fast forward almost 20 years, and a number of those barriers have been dismantled through the introduction of various initiatives such as TARGET2-Securities and regulations like CSDR, MiFID II and EMIR. >>>

>>> Looking at advances in post-trade practices more generally, we've certainly seen progress in derivatives reporting, designed to bring greater transparency to the market and therefore help identify the build-up of risk. There is a huge amount of data being reported at present – for example, DTCC's Global Trade Repository (GTR) alone processes trades relating to over 100,000 entities, with over 40 million positions translating into a billion messages each month. However, reporting practices are not without their challenges. There is currently a lack of harmonised reporting requirements across jurisdictions. Data fields and standards, in terms of what is reported, by who and when, are very different, which makes the aggregation and analysis of this key data extremely challenging for regulators.

Further, the sharing of data held by trade repositories has not happened to the extent originally intended not only due to inconsistencies in the data being collected but also because of restrictions around legal and structural access. DTCC identified these issues as early as 2012 and has since maintained a dialogue with policymakers and market regulators regarding the need to implement standards globally and are encouraged by the progress being made in this area.

Notwithstanding some of the advances that have been made in harmonising Europe's post-trade market infrastructure in the areas of clearing, settlement and trade reporting, a significant number of the Giovannini barriers remain. Indeed, the European Post Trade Forum (EPTF), established by the European Commission in early 2016 in the context of the Capital Markets Union (CMU) project, should be commended for its review into and recommendations for achieving efficient and resilient cross border post-trade infrastructure in the EU.

Europe, in its broader political sense, has undoubtedly come a long way in enhancing its post-trade infrastructure, for both securities and derivatives trading and processing, resulting in a more unified and efficient market for its participants. However, we need to continue to move forward. A fragmented approach leads to increased costs for the underlying clients and will severely hamper the ability to derive greater value from Europe's capital markets. ●