

European Central Bank
60640 Frankfurt am Main
Germany

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EDDI.Initiative@ecb.europa.eu

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Subject: **AEM – Portuguese Issuers Association**
Response to ECB market consultation related to EDDI

The PORTUGUESE ISSUERS ASSOCIATION (AEM - ASSOCIAÇÃO DE EMPRESAS EMITENTES DE VALORES COTADOS EM MERCADO) welcomes the ECB market consultation on its possible European Distribution of Debt Instruments (EDDI) initiative.

AEM hereby provides its response to the consultation and is open for further dialogue with the ECB on this topic.

Below, we explain in more detail the main concerns, critical points and other matters why AEM believes that in the shape it is currently designed, EDDI is not an appropriate solution for the problem indicated in the Eurosystem's consultation.

A. Main Concerns

1. Post-trade mechanisms allowing the issuers to reach out to investors based in different markets (in Europe and beyond) already exist today and same day distribution of issuance to investors in other EU Member-States in Central Bank money is also possible thanks to CSDs links and T2S operations; in this context, Issuers can reach a wide range of European and international investors.

In parallel, harmonisation efforts have been ongoing in the post-trade field in Europe.

However, it is true that there are still many barriers to an efficient EU cross-border clearing and settlement, and that current issuance systems and procedures are costly and inefficient due to the necessity for maintenance of a multiplicity of connections (links) with different procedures, standards and resources.

A part of this problem is the direct result of successive waves of regulation, sometimes misguided and contradictory in its goals; for example, the ongoing CSDR implementation shows that CSDR itself gives rise to additional barriers, such as the creation of a new lengthy procedure for a CSD to accept issuance of bonds of an issuer from a different EU jurisdiction or hurdles to DVP settlement in multiple currencies for a CSD without a banking licence.

2. AEM is a strong supporter of harmonization through market-led initiatives; but, as a matter of principle, AEM considers, and empirical evidence confirms, that large, centralized and public managed services are not the adequate market structures to foster innovation and new market models.

So, regarding public sector initiatives it is our belief that no specific model or solution shall be pursued before having reached a common and thorough understanding of how the markets work, what are the exact roles and responsibilities of the various actors in the issuance process, and what and where improvements are needed.

Even if the objective of the ECB is to develop a pre and post-trade market infrastructure more efficient, cheaper, less complex and globally more competitive, creating a centralized public service, we believe that the option proposed by the ECB does not seem to be the right solution, as the ECB proposal configures a more complex and probably costlier infrastructure, which may result in a concentration of the post trading with all the risks associated to such concentration.

3. Thus, in order to fully understand if the possible EDDI initiative is the right way forward (taking into account the evolving competitive environment and the specific situation of each local market), AEM believes that the output of the ECB consultation should incorporate further investigation on current inefficiencies and fully explore other solutions to address them.

In any case, the output of the ECB consultation must address and explain:

- the quantification of the perceived market need and demand that is not met by currently existing solutions, which should be included, explained and substantiated in the description of the problem statement;
- a detailed substantiation and quantification of market demand that is not met, and would not be met, by market forces following full implementation of T2S and CSDR, in the four areas of the consultation (*e.g.*, (i) Pre-issuance infrastructure (ii) Harmonisation in pre-issuance, (iii) Post-Trade infrastructure and (iv) Harmonisation in post-trade);
- a definition of the scope and value proposition of a solution (based on comparable private or public sector initiatives) to respond to those market demands;
- the complete rationale underlying EDDI, as well as the potential costs of it (*e.g.*, of establishing and maintaining a new set-up next to existing services and links), including the quantification of the envisaged benefits for all categories of EU Issuers and Investors, considering various scenarios of adherence to the project as Issuers and Investors may behave differently than ECB seems to assume.

4. In this context, and from the viewpoint of the Portuguese market, a number of concerns need to be addressed before any decision is made with regard to EDDI; considering the information currently available, EDDI is not an appropriate solution for the problem indicated in the Eurosystem's consultation.

B. Critical Points

5. It should be clarified in complete detail how the EDDI components would be delivered by the ECB and what would be its legal status, the contractual arrangements required and the regulatory treatment.

This, of course, includes answers to the fact that EDDI will create uncertainty regarding the identification of the place of issuance and the applicable law, as the ECB has also to comply with the requirement of Article 49 of the CSD Regulation.

These matters must be specifically addressed and solved; without clear, transparent and balanced answers to all the outstanding questions on the legal, fiscal, contractual and regulatory aspects of EDDI, our position will be of strong opposition to EDDI.

Also, we must emphasize that a “limited purpose” CSD or a similar legal structure, as originally envisaged by the ECB, in which the ECB conceives all contractual relationships with different Issuers to be governed by the laws of a single Member State (*i.e.*, the law of the Member State where EDDI will be established), is not acceptable because it will be detrimental for the positioning of Issuers in the Portuguese and in the European capital market.

6. As proposed, it seems clear that EDDI will weaken local EU CSDs by depriving them of a core revenue related to Issuer CSD services.

At the same time, if the result of EDDI implementation is that equities post-trade will become more expensive, this should also have a negative impact on trading, with trading venues becoming less attractive for equities Issuers (and also for debt securities of smaller Issuers).

Anyhow, depending on the number of issuers and size of issuance that would be distributed through EDDI post-trade, some or all EEA CSDs could be significantly weakened financially.

This would in turn be detrimental also for equity Issuers and smaller local Issuers of debt securities, as they would need to carry a more important part of the CSDs’ fixed costs and be obliged to seek alternative solutions for issuance, with potentially devastating impact on the smaller CSDs.

This strongly damaging impact on local ecosystems is clearly contrary to the objectives of CMU, as it would lead rapidly to an oligopoly among the CSDs that could withstand the impact on competition, with higher costs to Issuers as well as higher costs for retail and local Investors.

Any solution that increases the costs and difficulties for Issuers and Investors, and that eventually will require equity Issuers to seek alternative and more costly solutions for issuance, is not acceptable and will face strong opposition.

7. AEM strongly believes that a concept of “neutrality” is not a pre-requisite for the efficient functioning of the European capital markets which is fully based on non-neutral, commercial parties in the fragmented area of trading, issuance, market making, clearing, settlement, asset servicing, collateral management, asset management, etc.

We believe it is not in the EU single market objectives that some parts of the market’s functioning would be taken on by a “neutral” party as this could lead to an actor *supra partes* not subject to competition and, therefore, to a monopolistic situation contrary to the principles of organisation of the EU, and source of strong technical, operational and business risks.

8. Specifically, as no cost and efficiency analysis of the EDDI business case and a reflective analysis on the impact of the EDDI in the market are available, and because the extent and the nature of the need of the market in the areas of pre-issuance and post-trade are not obvious or substantiated, the value proposition of the EDDI business case, compared to the existing pre-issuance arrangements, is not clear.

As described, the proposed EDDI model implies the introduction of an additional layer of complexity in the custody chain of service providers, and as such of additional cost.

In fact, ECB proposes to introduce a further top layer of accounts (CSD accounts in EDDI), on top of the current custodian bank accounts in CSDs, as EDDI will not deal directly with custodian bank or investor accounts.

In a world where Issuers and Investors need cheaper and simplified post-trade value chains, and where new technologies (*e.g.*, blockchain) are starting to enable more decentralized and efficient post-trade models, such a centralized and more complex proposition does not provide the future benefits that the markets expect.

Therefore, EDDI will not change the current status and, on the opposite, EDDI will add an additional level of complexity and fragmentation in the structure of the CSD links, by adding an additional intermediation layer, and an additional optional model, which advantages are not clear.

On the contrary, we consider that a public intervention without a publicly acknowledged market failure could pose a risk of distorting the functioning of the market and creating further market fragmentation, originating more costs for Issuers and less efficient services, as it was already the case with T2S, which is not acceptable.

9. Likewise, the reason for proposing EDDI at this point is not clear.

CSDR has not yet been fully rolled out; similarly, the deployment of T2S is still ongoing with increased cross-CSD activity expected to materialise in years to come with the implementation of more CSD links.

T2S has come at a high cost for the market (infrastructures and market participants, namely Issuers) while the real benefits are still to be reaped (*e.g.*, cross-CSD settlement has not significantly increased through T2S links yet).

Consequently, implementing EDDI now would seem premature and is most likely to have negative impact in other initiatives, like the the ongoing implementation of the Regulation (CSDR), that promotes increased competition amongst CSDs and where Issuers can choose the Issuer-CSD that offers the most appropriate services.

In addition, CSD links (both within and outside T2S) allow Issuers to access investors in other EEA and CSDR-equivalent third-country markets through their chosen CSD.

CSDs have been developing and expanding their services to Issuers, allowing European Issuers and Investors to leverage competition to receive high-quality market infrastructure services tailored to their needs in specific areas.

EDDI risks distorting the market functioning as an approach that is not coherent with the European Union Single Market objectives of more competition and private solutions, rather than public intervention in commercial service provision.

Besides, if the proposal to create EDDI indicates that the ECB does not believe that T2S and interoperability between T2S CSDs would reach the objectives initially set out when the T2S project was launched, why shall the market invest in a new unproven solution?

C. Other Matters

10. On the other hand, considering the policy objectives underlying the CSD Regulation, which are to bring more competition, interoperability and connectivity between CSDs, and the objectives of the European Union Single Market, of more competition and private solutions rather than public intervention in commercial services provision, the creation of a “limited-purpose” CSD, or a similar legal structure, by the ECB, is a contradiction with European objectives and risks distorting the market functioning in the CSD area.

Currently, the CSD Regulation establishes a structure of inter-CSD access (CSD links) which enables European Issuers to have their securities issued through one CSD available to the participants of all linked European CSDs (potentially reaching all European investors).

In this context, the T2S CSDs, acting as investor CSDs, can, potentially, offer settlement in central bank money in all T2S markets, building a real “CSD network”.

CSD links, which are being established at good pace, set the stage for a fully integrated EU market infrastructure, benefiting from lean and efficient cross border transactions, and at the same time keeping optionality and competition among private providers.

This model, in which all CSDs have been working and planning, and that Issuers are paying through the established fee structure, now seems at risk with the EDDI initiative, contrary to its spirit and a new source of costs for companies.

11. With EDDI, as a “limited-purpose” CSD or as a platform included as a Target service, the ECB envisages to enter a commercially competitive area, as a service provider.

While the EDDI is being referred as a “so called” non-profit initiative, the ECB intends to transform a competitive private landscape into a centralized public service.

And, although EDDI is said to be optional, in fact it will only justify itself if there will be significant attraction of Issuers.

In this context, it is our understanding that only if it is clearly proven that the current service providers (CSDs) are failing to provide the services that the market needs at reasonable costs (a market failure), and that there is no other way to achieve those results (*e.g.*, by further competition regulation initiatives, cost monitoring, harmonization, transparency rules, link developments, etc), and that a public service, as a last resort solution, will be permanently less expensive and more efficient will the EDDI model be justified notwithstanding the above mentioned outstanding questions and concerns.

But, even in that case, we will not agree with the ECB performing simultaneously a number of different and conflicting roles: as regulator, collateral taker (user of CSDs services), Overseer, T2 operator, T2S technical provider, and, with this initiative, as CSD competitor.

Therefore, at least without further and best detailed information we consider that this new commercial, competitive and non-neutral role for the ECB is not compliant with the functions and the mandate of the ECB and, most importantly, it is not the best solution for the EU capital markets and specifically for the Portuguese capital market, as the competition of different roles run simultaneously by the ECB may have a disruptive impact on the market, especially if EDDI would position it as a service provider in a commercially competitive space.

D. Conclusions

12. We understand that a number of Issuers across Europe may see a need for further harmonisation and standardisation.

However, it is not clear why this could not be accomplished in a fair and competitive environment, similar to different harmonisation efforts that the market itself is achieving, *e.g.* in the post-trade (such as on corporate actions) and end-to-end (such as on the distribution of international debt instruments).

Further to that, we believe that a possible EDDI solution, as described, in any case, may only address a part of the existing Issuer/Investor patterns.

Indeed, within the pattern of European Issuers issuing in Euro only, many of the companies are local Issuers and do not expect to develop their reach beyond the Member-State borders.

At the same time, the patterns regarding European Issuers issuing in Euro and foreign currencies, or Non-European Issuers issuing in Euro and potentially other currencies, are rather international than solely Euro-zone specific, such as an EDDI solution would be.

Thence, EDDI seems to rather increase the number of different channels, or at best only substitute existing channels, a result that, clearly, does not justify the incurred investment and costs.

And, in any event, if EDDI post-trade intends to be used by EU supranational issuers to distribute their euro-denominated debt securities, according to ECSDA numbers this would account for maximum up to 7 % of the total amount of outstanding euro-denominated debt securities, already under the assumption that all EU supranational issuance would be through EDDI.

This means EDDI would possibly be developed only for a limited number of issuers/issued securities; all other existing arrangements would remain in place. This further reinforces our view that EDDI would represent a new additional layer/possibility in the pre-issuance/post-trade space, increasing rather than decreasing complexity/fragmentation and increasing rather than decreasing the total costs for issuers or investors.

13. On the other side, we would like to remind that any project needs to be carefully prioritised *e.g.* against those that result from mandatory regulatory requirements.

EDDI could easily become a undesirable distraction, of attention and resources, from priority topics, like the urgent transition for a sustainable model for Europe's future development, which will be detrimental and damaging not only for Issuers but all local markets and the European economy.

14. Given the current available information, we cannot see the benefits to reap for EU Issuers and Investors and even the value proposition for the European supra-national issuers is not clear as the participation of non-European investors, such as from Asia, is not considered.

AEM believes that the main issue preventing further scaling possibilities for Issuers and enhancing efficiency and depth of issuance across different EU markets is to obtain a coherent legislative and fiscal environment across the EU countries.

Namely, the tax environment applicable to debt issuance is an element of significant difference, in which it is essential to identify a path for further harmonisation.

Similar challenges apply in what regards Securities Law, where harmonisation could be a major catalyst.

Also, at national level, action by national regulators in furthering competition regulation initiative, or cost monitoring and pricing control, in order to decrease high costs and limited competition, can be envisaged and would be of utmost importance.

Without such reforms, actions undertaken by public actors, against the will of the majority of market actors, will not bring substantial benefits.

We, therefore, believe that, within a coherent legislative and fiscal environment, private commercial initiatives should be successful in order to advance towards this goal and that the objectives which could justify the implementation of EDDI should be part of the EU policy-makers reflections on a possible plan of action, built with the support, alignment and agreement of market actors, following dialogue between the ECB's and the European Commission's with stakeholders (who must, mandatorily, include all types and nationalities of Issuers).

15. Given the above-mentioned main concerns, critical points and other matters, AEM believes that, considering the current proposal, EDDI is not the appropriate solution for the problem indicated in the Eurosystem's consultation.

As a consequence, we recommend that the ECB considers the above-mentioned main concerns, critical points and other matters and that no further decision on EDDI is proposed without a full assessment, quantification and substantiation of the answers to the referred matters.

We would be pleased, of course, to discuss the content of this letter or to provide any further clarity with regard to the statements made.

Yours faithfully,

Abel Sequeira Ferreira

Executive Director