Friday, 24 April 2015

**KDD response to the EBA on CSD prudential requirements**

This paper constitutes KDD's response to the EBA Consultation Paper of 27 February 2015 on draft Regulatory Technical Standards under Regulation (EU) No 909/2014.

KDD is a CSD operating in the Republic of Slovenia. Legislation currently in force in the Republic of Slovenia (Markets in Financial Instruments Act – ZTFI) requires of KDD to hold at all times adequate capital enabling standard business conduct and considering the business volume and risk exposure. Minimum such capital is set at 125.000,00 EUR and reflects rigorous requirements of ZTFI with regard to assumption of (counterparty) credit risk which is strictly prohibited and the supervision of its participants’ liquidity which is to be carried out constantly.

Initially, KDD would like to endorse the response provided to EBA by ECSDA (European Central Securities Depositories Association) in its entirety. KDD would like to emphasize additionally the ECSDA recommendations Nr. 1, 3, and 4, which advise against the framework in place for banks to be used for entities that do not (and are neither allowed to) extend any credit, advise against the overlapping of capital requirements and advocate for the observance of CSD’s low risk profile.

Furthermore, Regulation (EU) No 909/2014 itself and its annexes systematically differentiate types of services provided by CSD. This systematization should be the focal point for calculation of required capital for CSDs.

As far as individual types of risks are concerned, one should observe that providing custodian services for securities is an inherent part of CSD business. Therefore, on a CSD level custody risk is just another denotation for risks stemming from standard conduct of business and should be consequently included in other types of risks, most suitably in operational and legal risks as already envisaged in the heading of Article 4.

Following the ascertainment that CSDs such as KDD not only do not conduct banking type of services but are even prohibited to assume (counterparty) credit risk, the determination of capital requirements regarding the investment risk should not have as its starting point the whole balance sheet size with exclusion of certain items. Quite the contrary, only specifically listed balance sheet items should create a basis for capital requirements for the investment risk, such as financial investments and claims to the clients. Any further items should be added only after thorough consideration of actually conceivable risks.

Calculation of capital requirements for business risk should properly observe that CSDs such as KDD conduct predominant part of its business with clients that are strictly regulated entities themselves, namely banks, brokerages, insurance companies, and investment companies. We refuse to believe that all the regulatory requirements that these entities are subject to, would bear no significance with regard to their capital strength and resilience. If such regulatory requirements bear substantial significance with regard to capital strength and resilience of those entities, as we believe it is the case, then this fact should be acknowledged through lower levels of business risk and lower levels of CSD’s capital requirements.

As far as capital requirements for winding-down or restructuring are concerned, one cannot disregard that the plan referred to in Article 47(2) of Regulation (EU) No 909/2014 is not a plan that CSD could adopt and maintain irrespective of competent authorities. Would there be unrealistic assumptions in such a plan, the matter should be dealt with by necessary adjustments in the plan itself and not by generally disregarding every plan with an estimated time span shorter than six months.

Finally, we wish to stress the importance of clear and unambiguous definitions from the definition of capital on. We believe that the latter lacks clarity at least with regard to net profit of the current period, revaluation surplus and provisions.