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Discussion Paper on draft technical standards under the CSD Regulation

Dear Sir, Madam,

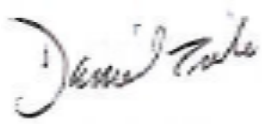
We welcome the opportunity to respond to ESMA's discussion paper on draft technical standards for the regulation on improving securities settlement in the EU and on central securities depositories (CSD).

Our response focuses on the priority issues relating to settlement discipline and those we consider important as a CSD participant. In particular, the mandatory buy in rules will have major impact on markets (particularly fixed income) and so we support their calibration as appropriately as possible. To this end, we have made a number of suggestions as to how the regime could be tailored accordingly; as far as possible buy ins need to be allocated to the correct participants and conducted over an appropriate timeframe in accordance with the features of the instrument in question.

The issue of banking services provided by CSDs is also important and we look forward to responding to the consultation from the European Banking Authority (EBA) on this subject.

We hope you find these comments useful. Please let us know if we can provide further information.

Yours sincerely,



Daniel Trinder

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Q1: Which elements would you propose ESMA to take into account / to form the technical standards on confirmation and allocation between investment firms and their professional clients?

The standard post trade and pre settlement processes that exist in the market today should be taken into account. There are a number of recognised industry tools for electronic confirmation and affirmation which would provide a useful reference point[1]. Confirmation matching should include not only economic details but also standard settlement instructions (SSI).

In respect of timing, allocations should be sent and confirmations received on trade date. An electronic affirmation should be issued by the investment firm upon receipt of the confirmation as close to trade date as possible. However, time zone issues need to be taken into account for clients based outside of the EU.

Q2: In your opinion, are there any exceptions that should be allowed to the rule that no manual intervention occurs in the processing of settlement instructions? If so please highlight them together with an indication of the cost involved if these exceptions are not considered? Do you consider that this requirement should apply differently to investment firms? If so, please explain.

Automated procedures should be the general rule for the processing of settlement instructions at CSD level. It is difficult to estimate the costs involved but exceptions to this are justified because manual intervention enhances settlement efficiency by allowing mistakes to be corrected where settlement instructions may have been inputted incorrectly. This is not an uncommon occurrence.

Manual intervention should also be permitted as an alternative communication channel in case of any communication disruptions.

Q3: ESMA welcomes concrete proposals on how the relevant communication procedures and standards could be further defined to ensure STP.

There would be little benefit in ESMA prescribing the communication procedures and standards that CSDs should use and they are not required to do so by the regulation.

Communication procedures and standards are currently set at industry level where specialists are working on the definitions, harmonised market practices and their effective use by the broader securities' industry. The Securities Market Practice Group (SMPG) currently acts as the relevant forum for this.

Q4: Do you share ESMA's view that matching should be compulsory and fields standardised as proposed? If not, please justify your answer and indicate any envisaged exception to this rule. Are there any additional fields that you would suggest ESMA to consider? How should clients' codes be considered?

Yes, we agree that matching should be compulsory and aligned with T2S as far as possible. We also agree that there should be exceptions for instructions received with an "already

[1] Omgeo, FIX, SWIFT, Oasys CTM

matched" status and certain FoP (free of payment) instructions which are also sent to the CSD in an "already matched" status.

We do not think it necessary that the technical standards seek to standardize matching fields because matching is mandatory in the context of T2S where participating CSDs will have to fill in a certain number of fields. Markets not joining T2S from the start may likely have an intention to join at a later stage and should have the necessary flexibility to make their own progress towards T2S, hence we should avoid, for instance, that they have to update systems that will be disconnected once they join T2S. The most that ESMA should propose is a non exhaustive list of matching fields.

Moreover it is widely recognized that a certain tolerance level on the settlement amount could be considered. In order to determine this, a similar approach as T2S can be applied. ESMA should provide for the possibility to use amount tolerances to increase matching efficiency. In no cases should tolerances be accepted for differences in notional amount.

Q5: Do you agree with the above proposals? What kind of disincentives (other than monetary incentives such as discounts on matching fees) might be envisaged and under which product scope?

We support the response provided by the T2S Task Force on settlement discipline on this topic, which inter alia described:

- There is not necessarily a correlation between early matching and high settlement efficiency (one of the core objectives of the Settlement Discipline Regime);

- Early matching (while very beneficial) does not guarantee a high degree of settlement, as other elements need to be clarified for a transaction to settle (i.e. available resources, non-hold-status); and

- A best market practice of having transactions matched in the securities settlement system by close of business on SD-1 would significantly increase the available resources in the overnight-settlement batches.

In many cases, requiring settlement instructions to be submitted at ISD-2 is practically very difficult owing to the global nature of a custodians client base. Direct market access (DMA) or prime brokerage clients which are based in the US often send trade files at close of business US time which would likely miss the EU deadline.

Prior to the introduction of monetary consequences, the regular production of statistics which could be benchmarked against the overall market would provide a tool-kit to CSD participants and serve as an incentive to analyse the reasons for settlement instructions not matching and lead to improvements in matching efficiency. It might also be sensible to analyse the status quo by market across Europe and analyse developments over time.

Q6: In your opinion, should CSDs be obliged to offer at least 3 daily settlements/batches per day? Of which duration? Please elaborate providing relevant data to estimate the cost and benefit associated with the different options.

Three daily settlement batches should be the minimum, but ideally CSDs would meet T2S standards which require real time settlement during the day, and batch settlement overnight.

Problems are encountered in specific European cross-CSD markets today where, due to the chain of intermediaries in a transaction, a specific trade can fail if it is received too late in a specific CSD settlement cycle and therefore cannot be onward delivered to another CSD until the following business day, thereby attracting a CCP fine (under the short selling regulation) or a CSD fine. Future settlement algorithms at CSDs should therefore ensure the maximum possible efficiency of settlement, including ability to partial, if agreed by the counterparties or specified in the CCP rules.

Q7: In your view, should any of the above measures to facilitate settlement on ISD be mandatory? Please describe any other measure that would be appropriate to be mandated.

We do not support CSD's 'shaping' trades and settlement instructions. This amounts to an excessive amount of discretion for a CSD to exercise.

Partial settlement should be undertaken at the discretion of the settling parties only and should not be mandatory. We would note that T2S provides optionality around partialling on a trade by trade basis.

Q8: Do you agree with this view? If not please elaborate on how such arrangements could be designed and include the relevant data to estimate the costs and benefits associated with such arrangements. Comments are also welcome on whether ESMA should provide for a framework on lending facilities where offered by CSDs.

We agree. Based on experiences in various CSDs or ICSDs we do not think a CSD can provide securities lending facilities in a proper manner.

Any automatic lending would need to be with the explicit consent of the borrower.

Q9: Do you agree with the above monitoring system description? What further elements would you suggest? Please present the appropriate details, notably having in mind the current CSD datasets and possible impact on reporting costs.

We broadly agree with the system described for monitoring settlement fails.

In terms of additional elements, we would recommend including the ability to view performance over a span of SD ,SD+1, SD+2 etc. up to buy-in. This could also be organised in peer groupings, so that members with a similar business model (e.g. international broker/dealers, local brokers etc.) are benchmarked against their peers and not each other, as performance is often impacted by the location of their client base, and the span of markets in which they operate.

Q10: What are your views on the information that participants should receive to monitor fails?

Members should always have access to near real-time trade status information, near real-time settlement confirmation, and be provided with valid reason codes for any unmatched or failing trades, with recommended courses of action where possible from their providers.

Participants should also be provided with aggregated information on fail rate, key reasons, percentage by key offenders on a monthly basis.

Q11: Do you believe the public information should be left to each CSD or local authority to define or disclosed in a standard European format provided by ESMA? How could that format look like?

ESMA should determine a standard European format for the provision of public information by CSDs so that it is uniform and allows for comparison. As specified in the regulation, this should be on an aggregated and anonymised basis.

Q12: What would the cost implication for CSDs to report fails to their competent authorities on a daily basis be?

No comments.

Q13: CSDR provides that the extension period shall be based on asset type and liquidity. How would you propose those to be considered? Notably, what asset types should be taken into consideration?

Shares deemed liquid or illiquid could be referenced to the list of liquid shares kept by ESMA under MiFID 1. We agree that the criteria specified under Article 2(1) (17a) of MiFIR could be used for assessing the liquidity of non equity financial instruments.

An extension period will also be necessary for at least ETFs and fixed income instruments including structured finance products and convertible bonds due to their bespoke and less liquid nature.

Q14: Do you see the need to specify other minimum requirements for the buy-in mechanism? With regard to the length of the buy-in mechanism, do you have specific suggestions as to the different timelines and in particular would you find a buy-in execution period of 4 business days acceptable for liquid products?

The ESMA process needs to be sufficiently detailed so as to ensure uniform settlement discipline procedures for buy in and settlement fines across all markets.

Consistent with the regulation, whilst CSDs may include in their rules an obligation for participants to be subject to buy ins and penalties, CSDs should not themselves perform buy ins or take on buy in risk. CSDs should be able to appoint market professionals (brokers) to perform buy ins on their behalf.

Although the level 1 text is not entirely consistent on this issue, it should be clear that the failing participant is not always necessarily the participant that fails to deliver the relevant instruments. Settlement fails happen for a variety of reasons which might include in a chain transaction where the seller has not been delivered to by another participant. Paragraph 7.1 talks about failing participants as those who cause settlement fails, without reference to them being the participants that ‘fail to deliver’. This principle should be carried through this section, in so far as the level 1 regulation permits.

ESMA need to ensure that there is a clear description / definition of a 'concerned party' which allows for identification of the actual buyer and seller relevant for the buy in along the value chain (i.e. CSD - participant / sub-custodian – global custodian – investor). This should allow for the possibility to pass buy ins on so there are not multiple buy ins on the same instrument.

A buy in execution period of four business days would be acceptable for liquid products. For non liquid products, longer extension periods would be necessary, up to the maximum of seven business days.

ESMA should specify a cap on the length of the deferral period during which the execution of the buy in can be deferred to a later date at the discretion of the impacted participant. Through analysis conducted with CCPs and AFME in 2013, it was identified that on very few instances was a buy-in successful on a second attempt. If a buy in cannot be executed immediately cash-out would be a sensible next step within a shortened timeframe.

If permissible within the scope of the regulation, the introduction of settlement fines should also be delayed until after the migrations to T2S have taken place. During this period of major change for CSDs, participants need time to adapt to the new procedures put in place by the CSDs and adjust behaviour accordingly to achieve a high level of settlement efficiency.

Q15: Under what circumstances can a buy-in be considered not possible? Would you consider beneficial if the technical standard envisaged a coordination of multiple buy-ins on the same financial instruments? How should this take place?

A buy in should be considered not possible in the following scenarios:

- the ultimate end offender cannot be correctly identified, such as in a chain of linked transactions (industry recognises this is a suboptimal situation and is working on a solution to resolve this issue and aims to share something with ESMA in July);

- there is a particular event on a certain security. This would include for example, 'liquidity events' where supply shortages occur (for example in Volkswagen prior to its temporary suspension in 2008);

- we agree with ESMA that a buy in would also not be possible where the securities to be delivered cease to exist, including because the maturity is reached during the extension period;

- where a failed settlement is because of 'unmatched' instructions where the terms of the trade have still not been agreed between participants

Q16: In which circumstances would you deem a buy-in to be ineffective? How do you think different types of operations and timeframes should be treated?

We agree with ESMA that a buy in would be ineffective for transactions where the forward leg is due within the time until the second business day after the expiration of the extension period. This is particularly the case for repo and securities lending/borrowing transactions.

However, even where the timeframe for the forward leg is longer than two business days after the expiration of the extension period, contractual obligations for a settlement fail will occur. Standard agreements usually provide for the cancellation, netting or roll-over of the late financial instrument. Due to these contractual obligations, a buy-in in respect of the settlement fail will be unneccesary and, therefore, ineffective. It should also be considered that the nature of a repo is a securitized loan and if securities are not delivered, no loan is granted.

Buy in's should also not apply to FoP transactions which are often linked to securities lending transactions (where returns are often open-ended from a value-date perspective). FoP transactions are also used where no underlying trades are taking place – where, for example retail account transfers take place from one bank to another and the same beneficiary is on both sides of the transaction. In this scenario, a buy in would serve no purpose as the underlying business does not involve a cash component.

Regarding Article 7 para 3 and 4 (b) CSDR, it remains unclear if the parties will both be obliged to mutually cancel the transaction or if they will have to flag the transaction ("buy-in is ineffective") accordingly when setting the original instructions. We would welcome clarity from ESMA on this point.

Transactions in open ended UCITS, ETFs and AIFs may also result in ineffective buy in procedures given that the buy-in could be covered directly by the issue of further fund shares.

Where exemptions from buy in rules are granted, they should not be put in place at the expense of the ability for CCPs to conduct effective netting at clearing level. This issue needs to be carefully considered.

Q17: Do you agree on the proposed approach? How would you identify the reference price?

We support the proposal but think the following amendments are necessary:

- Unless a buy-in is impossible or ineffective a deferral to a failed buy-in should be applied before the receiving party elects for cash compensation. The period for the deferral should mirror the buy-in period e.g. ISD+n; and

- The receiving party (buyer) should not be financially disadvantaged by the cash compensation process. Therefore, the cash compensation reference price should be higher than the original trade price.

Q18: Would you agree with ESMA's approach? Would you indicate further or different conditions to be considered for the suspension of the failing participant?

We would reiterate again the importance of identifying the failing participant which may not always be the party that 'fails to deliver' the instruments in question. Suspension of a participant could have major systemic implications and cause market disruption. It should therefore be preceded by a series of censures / fines to try to remediate poor settlement performance before a decision has to be made to activate a suspension. These issues

should be carefully considered in consultation with the respective competent authority before any decision is taken.

Q19: Please, indicate your views on the proposed quantitative thresholds (percentages / months).

In our view the volume of fails is more important than the value (otherwise a single large fail could push a party above the threshold), therefore in the model that ESMA proposes, both thresholds should have to be crossed.

For the second threshold, a 20% fail on volume of settlements across six months could be considered as a sensible starting point.

Q20: What is in your view the settlement information that CSDs need to provide to CCPs and trading venues for the execution of buy-ins? Do you agree with the approach outlined above? If not, please explain what alternative solutions might be used to achieve the same results.

The only definitive information that a CSD will be able to provide to a CCP or a trading venue are the details of a failed settlement at CSD participant level. As CSDR rightly provides for both segregated and omnibus account structures, it should be clear that this information will not always permit a buy in to be executed from this information alone (as the CSD participant will in most cases, not be a party to the failed trade, but simply an intermediary).

For CCP cleared transactions, it will be sufficient for the CSD to provide the information of the failed transaction to the CCP. In contrast to other situations, the CCP in its position as buyer to every seller and seller to every buyer already is aware of the underlying failing party. We note that this is the case already today, where CCPs are direct participants of CSDs.

Transactions undertaken on a trading venue but not cleared through a CCP would usually be settled on a bilateral basis, i.e. trading participants need to send their own instructions to the CSD. If these instructions contain a trading venue reference, such information might enable the CSD to identify these as trading venue transactions and allow the CSD to inform the trading venue accordingly. Where a trading reference is not included, it would have to be questioned whether CSDs are in a position to determine such transactions.

In a case where there is no reference in the instruction making it possible to identify a trade venue transaction, a CSD would have to inform the respective CSD participant, who in its position as intermediary will then forward the information down the security chain (as per the process outlined in question 14). The actual trading participant would then receive the information, could then identify this as a trading venue transaction and inform the venue accordingly.

Q21: Would you agree that the above mentioned requirements are appropriate?

Settlement internalisers should report information on both the value and volume of transactions they are internalising as well as information on the procedures used in settlement itself to allow for effective monitoring of risks that may exist where settlement takes place outside of a CSD.

However, the information requirements proposed by ESMA will require reporting beyond an aggregated level of volume and value and instead require reporting on the individual transaction level, which in our view goes beyond the remit of the Level 1 regulation.

On that basis we believe reporting should be split into reports which contain dynamic data on the volume and value of internalised settlements and a general assessment / provision of information of how internalised settlement is handled in the respective institution. Such processes usually would remain static and should only be reported if and when processes get changed.

This information should therefore include:

- Types of financial instruments / products settled;
- Types of operation – which should be read to mean identification of the type of transaction (DF/ RF / DVP / RVP) – if instructions are settled outside of a securities settlement system, custodian banks do not always know the true background of transactions, hence they only see the settlement instruction;
- Volume and value of failed transfer orders; and
- Underlying causes of failed transfer orders

We also think that ESMA should allow investment firms longer than 5 days after the end of each quarter to submit the relevant data to their competent authority, given the volume of information that is being requested and the fact that a number of such transactions could already be archived by the participants.

Q26: Do you agree with this approach? Please elaborate on any alternative approach illustrating the cost and benefits of it.

We agree that the recognition of CSDs should follow the general principle of non-discrimination between EU and non-EU CSDs. As a result we believe that non-EU CSDs should have to provide the same set of documentation to ESMA.

The CPSS-IOSCO Principles for Financial Market Infrastructures should be used as far as possible; CSD rules would have to be followed where they are not accounted for in the CPSS-IOSCO Principles. It should be easier to assess a third country CSD against a set of global principles as opposed to the specific requirements of the CSD regulation. CSDs should therefore provide an assessment against these principles when they submit their application for recognition to ESMA.

Q27: Do the responsibilities and reporting lines of the different key personnel and the audit methods described above appropriately reflect sound and prudent management of the CSD? Do you think there should be further potential conflicts of interest specified? In which circumstances, if any, taking into account potential conflicts of interest between the members of the user committee and the CSD, it would be appropriate not to share the audit report or its findings with the user committee?

We agree that the audit report should be shared with the user committee wherever possible. The audit report should not be shared where, for example, it contains sensitive information about individual CSD participants. A conflict of interest identified in the audit report should not automatically be considered a reason not to share the audit report and should be considered on a case by case basis.

From a user perspective, where the audit report is shared with the user committee it would also be preferable if it was made publicly available by the CSD. This would assist all users with their own due diligence activity.

Q30: Do you agree that the CSD risk analysis performed in order to justify a refusal should include at least the assessment of legal, financial and operational risks? Do you see any other areas of risk that should be required? If so, please provide examples.

We agree that potential CSD participants should be subject to a thorough analysis of their ability to meet the access requirements. However, in a majority of cases, participants will be subject to the relevant laws for investment firms (whether in the EU or otherwise) meaning they will already have had to demonstrate compliance to their relevant competent authority of most of the legal risks specified. In these scenarios, it should be sufficient for the CSD to confirm that an entity is subject to the relevant EU or non EU regulation and should not have the ability to require this information as a condition of membership.

It is worth noting that the operational risks listed may also be a reason to terminate or block a relationship temporarily if they are not met on an ongoing basis by a CSD participant.

We agree that the list of factors set out should not be exhaustive and CSDs should also be able to take into consideration other elements such as political or economical risks stemming from the application of a new participant.

Q31: Do you agree that the fixed time frames as outlined above are sufficient and justified? If not, which time frames would you prefer? Please provide reasons to support your answer.

The timeframes outlined for the response of the competent authorities seems unreasonably long and not proportionate to the risk of inappropriate access being provided. In a worst case scenario a potential participant would have to wait 10 months prior to on-boarding taking place. The on-boarding of a participant to a CSD should not be mistaken for the onboarding of a participant to a CCP, where significant liability risks could result from the market transactions participants engage in.

While the default of a participant can have significant knock-on effects in the market, those are probably more drastic in a CCP environment, than with the CSD.

Q32: In your opinion, do the benefits of an extra reconciliation measure consisting in comparing the previous end of day balance with all settlements made during the day and the current end-of-day balance, outweigh the costs? Have you measured such costs? If so, please describe.

Integrity of the issue will be key when entrusting securities to a CSD. As a result we believe that regular reconciliation will be of utmost importance and that the benefits of doing so outweigh the costs. In particular, if a discrepancy in holding is detected a security should no longer be available for settlement at the level of the CSD until this discrepancy has been resolved. Not allowing this could in times of high settlement volumes significantly increase the discrepancy.

Within T2S the functionality described in paragraph 144 called “blocking” allows CSDs to exclude securities from settlement when there is an inconsistency in their positions.

Q34: Do you agree with the approach outlined in these two sections? In your opinion, does the use of the double-entry accounting principle give a sufficiently robust basis for avoiding securities overdrafts, debit balances and securities creation, or should the standard also specify other measures?

We agree with the approach that has been outlined for common depositories. As a common depository services provider, we perform regular reconciliation on the securities issues that we safekeep.

Q43: Do you agree that links should be conditioned on the elements mentioned above? Would there be any additional risks that you find should be considered, or a different consideration of the different link types and risks? Please elaborate and present cost and benefit elements supporting your position.

In addition to those specified, environmental risks and political risks (political stability or risk of loss of securities) should also be considered.

For a standard link, the requesting CSD should go through a similar on-boarding process as a regular CSD participant (in addition to the procedure ESMA proposes).

For any link agreement be it standard, DVP, bespoke or interoperating, the place of settlement needs to be clarified for a given transaction to determine the underlying law that needs to be taken into account.