22nd May 2014

European Securities and Markets Authority
103 rue de Grenelle
75345 Paris
France

Submitted online: www.esma.europa.eu

Discussion paper on Draft Technical standards for the Regulation on improving securities settlement in European Union and on central securities depositories (CSD)

Dear Sir/Madam,

On behalf of the Association for Financial Markets in Europe (AFME)[1] and its members, we welcome the opportunity to comment on the Discussion Paper published by the European Securities and Markets Authority (ESMA).

We agree with the analysis set out on pages 10-15 of the Discussion Paper that the elimination of the Giovannini Barriers and the facilitation of cross-border settlement do require both that the matching and settlement functionalities of CSDs be of a high standard, and that they be very significantly harmonised. Without such functionalities, some of the objectives of CSDR, namely the "creation of an integrated market for securities settlement with no distinction between national and cross-border securities transactions" (Recital 4 of the Level 1 text), and a high degree of settlement efficiency, will not be achieved.

On the topic of buy-ins, AFME recommends that further discussions should take place between ESMA, market infrastructures and their users, after the consultation deadline of 22 May, to consider what processes could be put in place to enforce the CSDR buy-in rules in 'non-CCP' scenarios. We are committed to working jointly with the other European associations

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[1] AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME was formed on 1 November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association. AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA) and is an affiliate of the U.S. Securities Industry and Financial Markets Association (SIFMA) and the Asian Securities Industry and Financial Markets Association (ASIFMA). AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

representing users and market infrastructures to try and develop a workable solution by mid-June in order for ESMA to take this into account when drafting the full technical standards on buy-ins, and for the EC when issuing its Delegated Acts.

INTRODUCTORY STATEMENTS/PRINCIPLES

1. The Post Trade area has seen significant legislation in recent years. Some has already been enacted whilst other areas are still to be determined. It is critical that ESMA recognises the number of cross references in CSDR level 1 to MiFID, MiFIR and the Short Selling regulation (SSR). Consistency and alignment between these pieces of regulation is critical including timings e.g. the current CCP buy in and fails regime under SSR will be replaced in CSDR but levels of fines and timing of implementation will need to be harmonised.
2. A clear definition of a settlement transaction is critical and necessary since all obligations under CSDR use this terminology. As mentioned at the public hearing in Paris, there should be a precise definition and how that applies to the underlying trade.
3. There should be a precise definition of a buy-in as it has not been described in previous legislation and is fundamental in order to implement this legislation. It should only be possible to buy in a security or apply a penalty to a purchase or sale transaction, or broader where there is a trade behind the settlement instruction. Where a settlement fail leads to an economical loss penalties and buy-ins could also be justified.
4. A clear definition of liquid and illiquid securities is the only way to determine how the settlement discipline regime can be implemented with appropriate calibration. This definition needs to be aligned across MiFID, MiFIR and CSDR and until such time the maximum extension period of 7 Business Days shall apply.
5. A settlement discipline regime must operate according to certain principles:
    a. The ultimate buyer and seller need to be identified.
    b. The failing buyer or seller should be penalised, not the intermediary (though the intermediary plays a role in passing on the required info to permit buy-ins).
    c. CSD participants, in their role as settlement intermediaries, should not be subject to a buy-in.
6. Penalties and buy-ins should not be applied multiple times on the same transaction or set of linked transactions. It is particularly important that the trading venues, CCPs *and* CSDs coordinate when applying the settlement discipline regime directing the buy in to the source of the fail.
7. AFME would like to clarify that a settlement fail and a buy-in are not always the result of a non performance by the deliverer of his settlement obligations. This could avoid penalising the wrong party or transaction in cases where:

- the receiver does not perform the right tasks to allow settlement (e.g. ensure sufficient funding for the purchase).
- External circumstances beyond the control of buyer and seller e.g. technical constraints or systems issues at the level of the CSD.
- Non trade related settlements: this is the case for settlement of corporate actions, for portfolio transfers etc (refer to question 17)

In the above cases we believe this should not result in a buy-in.

8. ESMA and/or the EC should stipulate precisely which trades are captured and on what basis (trading venue, location, applicable contract law). This is crucial to determine what the territorial application is of the penalty and buy-in regime for trades concluded outside of the EU, but settled in an EU CSD.
9. In a large number of areas there are industry guidelines and best practices that should be used as the basis for further standard setting e.g. ESF/ECSDA matching standards/ T2S matching standards.
10. It is essential to ensure a consistent and uniform application of settlement and buy-in regimes across different trading venues, CCPs and CSDs so to enable efficient event management and economic certainty of delivery.
11. AFME does not believe that a "one size fits all" policy can be adopted for buy-ins and settlement discipline given the breadth of the European securities markets.
12. As noted both in the recitals in the Level 1 text, and in the ESMA Discussion Paper, SSSs play an important role. It is critical that any settlement discipline regime that results from the Level 2 process should not have the effect of creating disincentives for the early transmission of securities settlement instructions to SSSs.
13. Settlement internalisation is an efficient and widely-used form of securities settlements in the context of multi-layered chains of safekeeping accounts. Although there are no specific objections to the provision of regular reporting of quantitative and qualitative nature (with some suggestions, noted under Q17), AFME recommends that any measures creating restrictions over settlement internalisation should be avoided.
14. AFME supports the establishment of specific stringent criteria for the granting of authorizations to CSDs to offer banking type of ancillary services and is in favour of alignment of conditions for CSDs providing banking services under 1+2 model to the existing requirements under banking laws (e.g. additional capital surcharges and supervision requirements).

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?

There are three potential methods of confirming a trade with a counterparty:

1. Allocation automation – automation of the receipt and allocation of the trade pre-confirmation.

2. Trade confirmation affirmation – retains current allocation and confirmation medium but enables broker to receive positive affirmation.
3. Block matching and confirmation affirmation – full front to back solution for allocation automation and positive affirmation.

When a client allocates a trade to a broker, AFME believes that certain information should be available. It should be accurate and provided in a consistent and automated manner as close to execution as possible.
We have stated the fields which should be mandatory and a non exhaustive list of those which may be considered as optional. However, ESMA should consider how any changes to the mandatory fields could be adopted without full recourse to the regulatory process. Any procedure will need to be flexible and easily accommodate new market requirements.

Allocation Details from Client

- Order ID –Optional (this enables the broker to link the allocations to a trade within their systems)
- Fund id - Mandatory
- Broker – Mandatory
- Direction – Mandatory
- Stock identifier (ISIN, SEDOL, RIC, or others agreed at time of on-boarding) – Mandatory
- Quantity – Mandatory
- Price – Mandatory
- Trade Date (format to be agreed at time of on-boarding) – Mandatory
- Settlement Currency – Optional (mandatory if cross currency)
- SSIs- Optional (best practice to send)
- Value Date – (format to be agreed at time of on-boarding) Optional (mandatory if different from standard settlement cycle)
- Commission Rate/amount – Optional (best practice to include)
- Local Charges – Optional
- Net Consideration – Optional
- PSET – Optional (best practice to send)
- Commission sharing/soft flag -optional
- Accrued Interest- Optional

Trade Confirmation Details from Broker

The attributes, whether mandatory or optional and matching field or not, are subject to change in the future.

- Allocation ID provided in allocation message, assigned by vendor – Optional (mandatory if allocations were received from the vendor, this enables the vendor to link the allocations to a confirmation and perform cancel/amend)

- Trade ID (broker's internal reference) – Optional (mandatory if broker is only sending confirmations to the vendor)
- Message Type (New/Amend/Cancel) – Mandatory
- Client Identifier – Mandatory & matching criteria
- Fund id – Mandatory & matching criteria
- Broker Identifier– Mandatory & matching criteria
- Direction – Mandatory & matching criteria
- Stock Identifier (ISIN, SEDOL, RIC) – Mandatory & matching criteria
- Capacity (Agency, Principal) – Optional
- Bargain conditions (ex-dividend, cum dividend etc) - Optional
- Quantity – Mandatory & matching criteria
- Price – Mandatory & matching criteria
- Trade Date – Mandatory & matching criteria
- Value Date – Mandatory
- Place of Execution – Optional
- Time of Execution – Optional (need to agree on time format for MIS purpose)
- Commission Amount – Optional
- Local Charges – Optional (TBC whether to be grouped or broken down)
- Settlement Currency – Optional (mandatory if cross currency)
- FX Rate – Optional (mandatory if cross currency)
- Net Consideration in Trade Currency– Mandatory (mandatory and matching criteria for auto affirmation clients)
- Net Consideration in Settlement Currency – Optional (mandatory & matching criteria for auto affirmation clients' cross currency transactions)
- Payment Type – Optional
- # of Accrued Days – Optional
- Accrued Interest – Mandatory and matching criteria
- Yield– Optional
- Commission sharing/soft flag – Optional
- PSET – Optional
- Broker SSI – Mandatory
- Client SSI – Optional

AFME encourages ESMA not to issue a regulatory standard on the fields which are to be confirmed in order to maintain the required flexibility to adapt to evolving market practices.

For further details, please find attached AFME's Business Process Requirements Document relating to Block Matching, Trade Allocation and Confirmation Automation.

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 in those cases where manual intervention enhances settlement efficiency. Where settlement instructions may have been inputted incorrectly, manual intervention allows these mistakes to be corrected.

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.

We support the analysis set out in paragraphs 12 and 13, and would like to stress the importance of the use by CSDs of international open communication procedures and standards for messaging and reference data.

Among the areas in which further work is needed both to define and to implement such procedures and standards are settlement-related registration processing, and settlement-related tax processing.

In the context of T2S, and because of "lean" nature of T2S-processing, the decision has been taken that information relating to such processing cannot, and should not, be transmitted to T2S using ISO 20022 processing.

This leaves the question open as to how such information should be transmitted, in the cases that CSDs do need to receive such information. We believe that the European Post Trade Group is a suitable forum to sponsor work in this area.

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?

AFME shares ESMA's view that the T2S matching standards[2] (which compliment the ESF/ECSDA matching standards[3]) should be adopted. We recognize that more information is important to the matching and settlement process and therefore, if a party receives counterparty information in one of the optional fields established by T2S as a voluntary field, this should be used throughout the settlement chain. However, and importantly, if only one party sends this information, it must be allowed to "match to blank" in order to allow prompt settlement to occur.

The list of matching criteria should not be considered as definitive as it may change due to new regulation or new market practices. A change to the list should be possible without the need to refer back to the European Commission or European Parliament and within a short timeframe to accommodate new market practices or regulation.

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 agree with the proposal that all CSDs should offer hold/release mechanisms. We believe that in order to maximise settlement efficiency, and to allow matching to take place even though the necessary resources (securities/cash) for settlement are not yet available, all CSDs should offer full hold/release mechanisms (i.e. should allow CSD participants an unrestricted ability to switch the status of an instruction from 'hold' to 'release' and back to 'hold').

AFME fully supports the CSDR aim of ensuring early input of settlement instructions. However, it does not see the need for further disincentives given that markets are moving to a T+2 settlement cycle and fines will be applied as outlined by CSDR with effect from ISD+1.

AFME does not consider it would be practical or necessary to impose a deadline of ISD-2 for input and matching of the settlement instructions at the underlying CSD. Instead transactions with a T+2 or longer settlement cycle should match by ISD-1 end of business day, while for transactions with ISD with T+1 or T+0 settlement cycle, the trade should match on ISD. This would include the sending of instructions as early in the lifecycle as possible to enable the matching process at the CSD / T2S.

[2] http://www.ecb.europa.eu/paym/t2s/pdf/UDFS_v1_2_1.pdf?1e91fd88654af43bbbe310faff2c8731 Section 1.6.1.2

[3] http://ec.europa.eu/internal_market/financial-markets/docs/cesame/giovannini/20061023-esf-ecsda-matching_en.pdf

We note that a statistical exercise performed by ECSDA in 2012[4] shows no direct correlation between the matching rate on ISD-1 and the settlement efficiency rate on ISD. Therefore, a high rate of matching efficiency does not appear to guarantee a proportionally lower rate of settlement fails.

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.

As set out in our introductory comments, we do believe that it is important that the matching and settlement functionalities of CSDs both be of a high standard, and be very significantly harmonised. We believe that a CSD offering just 3 daily settlement batches per day would not meet these criteria.

As noted in our introductory comments, the CSDR Level 1 text, in Recital 4, refers to the "creation of an integrated market for securities settlement". In its discussion in paragraph 29 of how many settlement batches it would be appropriate for a CSD to have, the ESMA Discussion Paper seems to base itself on existing, segregated, securities markets across Europe, and not on a future integrated market.

Problems are encountered in specific European 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 cycle and therefore cannot be onward delivered 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. T2S, which has two overnight batches followed by a real-time settlement window, should be considered as a desired target model.

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.

AFME believes that early matching would be best achieved by CSDs offering the relevant tools to its participants to enable them to match as early as possible, with the necessary control over the settlement cycle. Examples of the tools required would include Hold and Release, linking and prioritisation. The various tools would be used as and when required by members, rather than mandated.
In addition, the CSD should provide its participants with appropriate reporting. This reporting should include instruction status of the participants'

[4] http://www.ecsda.eu/uploads/tx_doclibrary/2012_09_18_ECSDA_Statistical_Exercise.pdf

trades and reporting on matching or non-matching of settlements, with standard reason codes for non-matching where possible.

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 (or the CCP) 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. Any automatic lending would need to be with the explicit consent of the borrower and should in any case not be undertaken on a principal basis by the CSD to avoid undue risk.

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 ISD, ISD+1, ISD+2 etc. until buy-in. It may be helpful for regulators to compare the results of members with a similar business profile (e.g. international participants, local participants etc.) and benchmarked accordingly. Settlement efficiency can often be impacted by the location of the client base, and the span of markets in which the participant operates. These reports would be helpful to a participant, where the participant is identified and the other participants anonymised) as it would demonstrate how well they were performing in relation to their peers.

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

Members should always have access to near real-time settlement status information, near real-time settlement confirmation, with recommended courses of action where possible from their providers.

Participants should also be provided with aggregated information on fail rates, key reasons, and percentage by key offenders on a monthly basis. This should be provided in a standardised format to allow users to compare data across markets.

This allows members to apply these statuses through their internal infrastructures and workflow, to measure, manage, and cure failing trades.

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?

Preliminary comment on CSDR language
AFME notes that the language used in the discussion paper differs from that used in the final text agreed at COREPER and The European Parliament. Article 7.3 of the final texts states that "where a failing participant dos not deliver the financial instruments referred to in Article 5(1) to the receiving party within 4 business days after the settlement date ('extension period') a buy in process shall be initiated whereby those instruments shall be available for settlement and delivered to the receiving participant within an appropriate timeframe", whereas in paragraph 48 of the ESMA Discussion Paper, the text states the delivering party shall be subject to the buy-in within 4 business days.

The variance in language has potentially different consequences and is likely to have been a timing issue with various texts. Our comments are based on the agreed COREPER/European Parliament text. It would be helpful to have the exact text reconfirmed in the context of these deliberations.

Criteria for extension periods
AFME agrees that that the extension period should be based on liquidity and asset type as proposed by the regulation. Any framework for buy-in extension periods should take both criteria into consideration, while ensuring transparency on which extension period is applicable to each type of security.

These extension periods need to be harmonised as much as possible to avoid discrepancies between markets and platforms. This also includes harmonisation of CCP buy-in periods and regimes in different markets and CSDs.

We would strongly recommend that buy-ins are implemented in a phased approach. It may be wise to err on the side of caution and implement longer extension periods initially and then calibrate accordingly as the process becomes more stable. It will be important to start with only the most liquid instruments and asset classes as described above. In addition and as stressed in our introductory statements, we would welcome alignment between the definition of liquidity across MiFID/MiFIR II and CSDR.
Until this has been harmonised and an adequate calibration exercise has been conducted, we believe that a standard extension period of 7 days for bonds

(across government, corporate and high-yield) including cash and repo markets would be most appropriate to avoid distortions in the functioning of bond markets, and to avoid unintended consequences as a result of erroneous liquidity calibration.

For equities we recommend retaining the current buy-in period of 4 days for liquid securities, while allowing a standard 7 period for all other equities and related instruments pending above harmonisation and calibration (except 15 days for SME markets).

A. Asset type
A key differentiation needs to be made between bonds and equities. Both asset types are fundamentally different in nature, and in the way they are traded and settled. These differences influence trading patterns and liquidity, and thus justify different extension periods.

Equities
A further distinction needs to be made between highly liquid equities, with large turnover and market capitalisation, and smaller ones:

- For the former category, a standard buy-in period of 4 days across on-exchange/CCP cleared and OTC markets could be the norm, in line with the current regime in the SSR.
- For the latter category, which encompasses not just SME markets but also a number of equities which are less traded/are not included in main market indices, a longer extension period is warranted, based on the available liquidity as discussed below. This period can range between S+7 pending liquidity calibration and harmonisation (which can be later reduced to S+5 - S+7) to S+15, depending on the nature and liquidity of the instrument.

Buy-in periods for Depository Receipts based on equity baskets should be calibrated based on the composition of the underlying basket.

We agree with ESMA that ETFs should be considered as an asset type which requires a longer extension period of up to 7 days, both for the reasons ESMA provides as well as on account of the relative illiquidity of ETF units compared with other main market listed equities. We note that such an extension period should be aligned across primary and secondary market transactions in ETF units – e.g. the same period should apply whether the transaction represents an ETF issuer creating new ETF units at the request of an authorised participant or represents the onward sale of those units by the authorised participant to its client.

Fixed income

Contrary to equities, which are often traded on quote-driven trading venues, fixed income markets are largely OTC markets, where trading occurs predominantly off exchange, and a number of dealers act as market makers.

This influences the type of liquidity provided as explained below. In addition, special consideration needs to be given to the role of market makers regarding buy-ins.

Unintended market consequences may also arise from two exemptions provided for in the CSDR:

a. For ineffective buy-ins (for example, short term repurchase transactions) or;
b. Where failing CCPs are exempt from buy-in; these exemptions could shift the consequences of settlement failures on to cash market liquidity providers, market makers and other market participants, which will in turn have an adverse effect on liquidity in cash markets.

Within fixed income instruments, a first distinction needs to be made between lower grade corporate bonds and high grade corporate and government bond markets:

- For **corporate bonds**, trading liquidity is usually low, as they tend to be held in portfolios of end investors. As such, extension periods should at least extend to 7 days depending on the liquidity of the specific instrument.
- For **government and investment grade corporate bonds** of major issuers, liquidity is often provided by dealers who act as market makers and stand between buyers and sellers.

As these dealers are obliged to quote two way prices, they are highly exposed to counterparties delivering to them, in order to deliver onwards to other buyers. Whilst they usually maintain trading inventories to absorb some mismatches between receipts and deliveries, these are limited to avoid excessive costs for end-investors.

The higher the velocity of bond trading and settlement, the more exposed market makers are to settlement failures, penalties and buy-ins. As such, a stringent fining and buy-in regime impacting market makers, who are extremely exposed to failures in settlement chains, would have the adverse effect of reducing liquidity in bond markets, as dealers would be forced to reduce their activity in all but the most liquid instruments. Liquidity is likely to move away from smaller investors too and ultimately the end investor will suffer.

For this reason, AFME advocates that extension periods even for investment grade corporate bonds and government bonds should also be S+7 days as permitted by the Regulation, pending adequate liquidity calibration and harmonisation.

Liquidity
As stated above, it is essential to consider the liquidity of the instrument in order to calibrate the extension period. To the extent possible, it is vital to use the same categorisation (between liquid and illiquid) and calculation criteria across CSDR and MIFID/MIFIR II, to avoid confusion and discrepancies. This also requires that the calibration of liquidity in MIFID II needs be finalised before the buy-in regime in CSDR is finalised.

Specifically with regards to buy-ins, AFME would like to identify additional items that should warrant further attention in the calibration of extension periods:

- In bond markets, liquidity is often provided by a small number of primary dealers, who as market makers provide two way prices for buyers and sellers; that also means that the apparent liquidity of an bond may be misleading, and is determined by the ability of market makers to make prices, rather than a constant supply of buyers and sellers, like in major equity markets.
- Liquidity is not static, and depends very much on market circumstances: especially in dividend season or around future expiry dates, there may be a significant reduction in available securities to be bought or borrowed. Therefore, there may be a need to make adjustments to standard extension periods, if certain specific criteria are fulfilled, which would make buy-ins either impossible (see also below under Q15) or ineffective (see below under Q16).
- Consideration should be given to extending the buy-in period for other instruments that function similarly to ETFs. Global Depository Receipt (GDRs) and American Depository Receipt (ADRs) are single security baskets. Each unit of the GDR / ADR represents a multiple value of the underlying security e.g. 1 DR = 10 shares. GDRs and ADRs may be converted into the underlying security to fulfil settlement of a sale transaction or the reverse procedure where the underlying security is converted into a GDR / ADR for onward settlement of a sale transaction.

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?

With regards to the buy-in mechanism, we believe that the buy-in execution period should be no shorter than the settlement extension period for any given security (e.g. if a security was subject to S+7 extension period, minimum 7 days to complete the buy-in.

Also, we would like to make the following observations:

> The notice process seems to assume that notifications will be passed between settlement counterparties. However, it is the view of AFME that buy-ins and all related characteristics need to happen at the level of trading counterparties (buyer-seller), and not at the level of settlement intermediaries (CSD participants, sub-custodians and custodians), as stated in our introductory statements and key principles.

That implies that the required information to permit the issuance of a buy-in notice needs to be passed from the CSD level across the chain of settlement intermediaries to the level of the final buyer-seller. While most of this information (ISIN, trade reference, settlement counterparty reference etc) is already being provided through STP messages (Swift or other) and fails reporting, these may not be sufficient to issue a buy-in notice, and would require additional analysis and time prior to issuing the notice.

Some examples (non exhaustive) are:

a. The underlying root cause of the fail (which would justify the notice for the buy-in) may not be immediately clear from the settlement reporting: that could be the case if fail reason codes are not provided or transmitted (e.g. lack of securities, lack of cash), or because the settlement is not executed for other reasons (e.g. one side has issued a hold flag on its instruction).
b. If settlement instructions are unmatched or do not pass CSD validation checks, there is no single failing matched settlement instruction in the CSD, though there may be a valid trade behind them. Prior to the issuance of a buy-in notice, these reconciliation issues need to be resolved and it needs to be determined which instructing party made the error. It is possible that both parties could have made an error. Ideally an unmatched transaction should never be bought in as they may not be a party to deliver to.
c. Trading parties may be in different time zones and jurisdictions (see also the point in the introductory statements regarding territorial scope of the buy-in regulation) , which could lead to delays in obtaining the required info to issue the buy-in notice and transmit it to the counterparty. The difference in time zone would require at least one business day for any notice to realistically be passed to the ultimate investor and action taken.

d. As referred to under Q15 and Q16, there may be instances where a buy-in would be impossible or ineffective: That needs to be considered prior to the issuance of the buy-in notice.

e. Even after the notification is issued, it will take some time for the buy-in to be executed: a buy-in agent needs to be appointed, that agent will need to find the securities and quote a price, and ultimately these securities need to be delivered to the buyer. Even in a T+2 environment, that process will at least 4-5 days.

f. In addition, and as explained under Q15.2 below, multiple buy-ins for chains of settlement transactions need be avoided: even if a central party is found which can co-ordinate the buy-in, the identification of the appropriate place and amount of a buy-in will require some time. Moreover ESMA should consider that, in order to prevent multiple buy-ins, a buy-in can be forwarded should there by a subsequent pending purchase on the side of the defaulting party. This helps minimise the administration efforts and provides for a more realistic buy-in price.

g. Consistent definition and application of non-business days covering all relevant jurisdictions.

In summary, AFME believe that these elements need to be considered before defining a buy-in execution period, and in any case a standard fixed period of 4 days is insufficient to address and resolve the above considerations. The exception to this may be buy-ins by CCPs, where many of the above considerations do not apply, given the specific central role of the CCP in the trading and settlement process.

In addition, we would like to point out the need for standardisation of buy-in notifications, to permit specification of requirements with regards to how parties need to be informed of later settlements which could give rise to buy-ins.

Similarly, our analysis of CCP buy in processes shows a lack of harmonisation relating to the method used to achieve a buy in, ranging from using a single broker to an auction process involving multiple brokers. It is also essential that all information relating to the buy in procedure is publicly available to enable all parties to be aware of their obligations. The price of the buy-in should be available and the party executing the buy in must be subject to best execution rules.

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?

Q15 part 1: Under what circumstances can a buy-in be considered not possible?

There are two main categories of reasons preventing a buy-in from concluding successfully:

1. The security which is subject of a buy-in ceases to exist, or changes in nature or characteristics:
    a. securities come to the end of their life (e.g. as a result of a partial or full redemption, suspended securities).
    b. Asset classes that are convertible and redeemable should be excluded from buy-in when they are close to their redeemable / convertible dates: e.g. convertible bonds, warrants, bonds (all types).
    c. securities bought with certain attached rights (e.g. additional rights, 'cum dividend') are losing those attached rights, or change in nature, e.g. as a result of a right expiring or a dividend pay-out, issued securities subject to conversion resulting from merger and acquisition.
    d. The resultant security contains a covenant restricting ownership by investor type, market or region or the investor is restricted from holding the resultant security.
2. Even though the security still exists, there is not enough liquidity in the market to permit a successful buy-in. The loss of liquidity can be temporary or permanent. Some causes (non exhaustive) are:
    a. Trading liquidity disappears as a result of a temporary market event: in dividend season, securities often 'go special' and are not available to be borrowed (preventing a buy-in) or even bought.
    b. The demand for securities is much higher than what is available for sale: bid offer spreads widen, and securities might be temporarily unavailable. Some examples are:
        - Over futures expiry periods, certain lines of securities become the 'cheapest to deliver' and demand for those securities peaks
        - The composition of certain market indices changes (e.g. FTSE, Dax), triggering large demands for certain securities.
    c. Securities are temporarily blocked and cannot be delivered or settled any longer: e.g. as a result of corporate actions or international sanctions:
        - OTC Market Maker Securities with limited inventory (requiring private placements).
        - Depository Receipts with no headroom to convert from the liquid underlying to the Depository Receipt.
        - If the buyer ceases trading or is restricted from activities in the interim period (Insolvency, Sanctions, Court Orders) etc.

Most of these circumstances which can prevent the success of a buy-in can be determined beforehand, and should be considered ahead of starting the buy-in. It would be helpful if a (non exhaustive) list of circumstances preventing a successful buy-in could be included in ESMA RTS, in order to ensure transparency and objectivity.

Further ESMA should consider giving guidance as to the circumstances in which a buy-in can be considered impossible because securities are offered to the buy-in agent only at prices above a reasonable level. Whilst the need to ensure settlement discipline is an objective, a framework under which buy-ins can be executed at extremely high prices could act as a strong deterrent to the provision of liquidity by market makers.

Q15 part 2: 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?

We welcome ESMA's suggestion to draft technical standards that ensure co-ordination of buy-ins, provided they are effective in harmonizing buy-in regimes, minimizing the number of buy-ins and target the party (or parties) who caused the original fail. We see particular complexity where transactions are linked across market infrastructures. In this respect and given the complexity of these scenarios, especially when settlement chains occur across different market infrastructures, AFME is suggesting further detailed scenario analysis to be undertaken before mid- June (see point 11 of introductory statements) to analyse these scenarios in detail, and hopes to be able to provide ESMA with suggestions on the back of it.

As stated under Q13, securities markets are very inter-linked and individual settlements are often part of a much longer chain of buy and sell transactions, often across different markets. This is particularly prevalent in equity markets where CCPs stand between buyers and sellers, for bond markets where market makers provide two-way liquidity, and where trading positions are financed in the repo and stock lending markets.

This is in line with the principles stated under paragraph 16 of the introductory statements to the CSDR, which state that an effective buy-in regime should be:

- Adapted to the specificities of different securities markets, trading venues and certain complex operations such as very short term securities repurchase or lending agreements.
- Commensurate to the scale and seriousness of such fails, whilst being scaled in such a way that maintains and protects liquidity of the relevant financial instruments.
- Consider the impact on the activities of market makers, who play a crucial role in providing liquidity to markets within the Union, particularly to less liquid securities.

Regarding the question on how this should take place, we believe it is essential that the buy-in process is **optimized** and the number of buy-ins is effectively **minimised** (see point 6 of the introductory statement), whereby:

- The buy-in is executed against the party or parties who caused the fail, and not to other parties whose delivery is dependent on that initial trade to settle.
- The buy-in needs to be effected at the level of where the trade has been executed, and where a contractual buy and sell obligation has been created, and not at the level of settlement participants (see below).
- Where possible, there should be a mechanism whereby, if a CCP is involved as part of a transaction chain, it is in priority the CCP who executes the buy-in (or rather manages the CCP buy in process with a group of brokers). If somewhere in the trading chain a CCP is involved (who stands between buyers and sellers, the CCP should take the initiative to execute the buy-in, and other parties down the transaction chain should wait for that to be executed and settled, before attempting a buy-in themselves.
- It still requires that each party issues a buy-in notice, but the actual execution of the buy-in may be deferred if the party who receives the notice is able to evidence that a CCP earlier in the chain will be executing a buy-in which will trigger the subsequent delivery. As stated in the introduction, AFME will come up with further views by mid-June in collaboration with CSDs and CCPs on whether/how this could be implemented in practice.

In this respect, we would like to point out that the art 7.10 of the CSDR refers to monitoring by CSDs of the execution of buy-ins, with the aim of **minimizing** the number of buy-ins, which goes further than the co-ordination of multiple buy-ins as suggested by ESMA.

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?

AFME agrees that buy-ins should not be initiated where they are impossible to execute (Q15) or ineffective. We understand ineffective to mean that it is possible to execute a buy-in, but the buy-in would serve no economic purpose to either party.

There are numerous cases where a settlement does not represent an underlying contractual agreement between a buyer and a seller to sell securities against an agreed price.

Examples of transfers between CSD accounts which do not represent an underlying trade are (non exhaustive):

- Portfolio transfers between accounts of the same client at different custodians.
- Realignment of assets between a broker's own account and client accounts.
- Allocation of assets across different funds, or in different tax pooling accounts.
- Collateral movements and margin deliveries/reimbursements.
- Settlement as a result of corporate actions etc.

It is to be noted that these settlements are often free of payment, but not always: they can be DVP for a variety of reasons, and it is not possible to determine purely by looking at the settlement instruction if they represent an underlying trade.

Other examples of a potentially ineffective buy in are:
- Even though a buy-in serves an economical purpose, there is insufficient liquidity in the instrument to execute the buy-in, in which case there is either a deferral or cash compensation as foreseen in the art 7.7 of the CSD-regulation.
- Regarding the exemption of art 7.10 (b) regarding short-term repos and stock loans, we would welcome further dialogue to see how this could be best implemented in practice.

Once again, the industry workshop would seek to demonstrate each of the aspects where a buy in would be ineffective.

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

AFME agrees in principle to the proposal but suggests the following amendments to the proposed approach:
- Unless a buy-in is impossible (see Q15) or ineffective (see Q16) 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.

The receiving party (buyer) should be adequately compensated for the lack of receipt of securities. However, in no case should it lead to overcompensation or an arbitrage opportunity for the buyer.

In this respect, we would like to point out that there could be a contradiction between ESMA's statement that:

- cash compensation "*should be based on the need to "settle" the original trade and it should aim at determining a price for the security, allowing* *the buyer to be compensated for the fact that he did not receive the securities he bought*"

AND

- "*the cash compensation shall only be due when the prices of the financial instruments agreed at the time of the trade are lower than the last publicly available prices for such instruments.".*

*Cash compensation should indeed consid*er the difference between traded price and last publicly available price (if available), but it should go in both directions, i.e. if prices go up, the seller compensates the buyer, but if prices drop, the buyer compensates the seller.

If there is only a one-way compensation, the buyer could make a windfall profit, despite the fact that he had previously already agreed on a purchase price with the seller. In extreme cases, this could lead to fail arbitrage on the side of the buyer.

In this context, it is to be noted that fails occur not just because the seller fails to deliver, but can also occur if the buyer fails to purchase the securities. If the settlement fail is due to a fault of the buyer, he should naturally not be entitled to compensation (or be able to trigger a buy-in).

When identifying the reference price for the cash compensation of an OTC transaction the following scenarios need to be considered:

- Price discovery for certain OTC traded asset classes / instrument types (specifically illiquid securities) may be difficult due to their low / non-existent turnover.
- Therefore, the last 'reference' price may be considered 'stale' i.e. it has remained static for a prolonged period and not suitable for buying-in / cash compensation purposes. It should be noted that the same situation is potentially applicable to certain securities traded on recognised trading venues.
- A definitive timeframe should be determined for considering if a last market reference price is suitable for buying-in / cash compensation purposes.
- If this period has lapsed and the last reference price cannot be used then a premium tolerance e.g. nn% is applied to the original trade price to appropriately compensate the buyer of the securities. This particular practice is employed today by a number of CCP's as part of their buy-in procedures for equities.

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?

The suspension of any participant should be considered with the greatest care. There are multiple reasons for a failing trade and these may not be under the control of the participant. This could have serious consequences for the party involved, similar to those when a CCP declares it's counterparty in default. Similar conclusions may be drawn if a participant is suspended at the CSD. AFME believes that this should be only be used as an absolute last resort.

As referenced in the introductory statement 5 and 7, where CSD participants settle instructions on behalf of others, it may not be the particpant's fault that the transactions failed. A lack of securities or cash or erroneous instructions from the trading participants would provoke a fail. In those cases, the CSD participant should not be penalized, as it is due to no fault of his part that settlement fail and buy-ins are triggered.

Failure by a CCP to deliver should be taken into consideration for the determination of any threshold, as they often cause participants to fail onward deliveries. Consideration should also be given to the liquidity of the instruments whilst suspending participants could result in the reduction of liquidity which is at odds with ESMA's aims (see above for market makers). The underlying causes should first be analysed over a sufficiently long period of time. If the decision is taken to suspend a participant, an appeals procedure should be available to the participant.

The proposal to suspend a CSD participant is contradictory to proposed recovery and resolution plans for banks where a business is continued for as long as possible. Consideration should also be given to extreme market events, the effect of which has a damaging effect on participants that may not have been involved in the event. Finally, the impact to CCPs and CSDs should be considered as suspension of a large market participant is likely to affect their settlement rates, increase fails and damage settlement liquidity.

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

The thresholds should be devised so that equivalent parties can be compared with each other, and within the participants, by asset type. We would argue that "one size fits all" approach is not appropriate in this circumstance. Even if one or more thresholds are included in technical standards, it should be clear that the suspension of a participant should never be triggered automatically once the thresholds are reached. Some degree of discretion is needed for the CSD to consult with regulators and assess the possible consequences of a suspension for systemic risk.

We believe that it would be better to establish a threshold relative to the average market settlement efficiency rather than an absolute threshold. This would take consideration of the specifics of each market/instrument, while still serving its purpose to improve market settlement performance.

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.

CSDR rightly provides for both segregated and omnibus account structures. This principle should be respected. Regardless of whether the buy in occurs on an omnibus or segregated account, settlement institutions have sufficient information to advise the trading counterparties/CCPs of the buy in on the basis of the transaction to be settled.

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 is aware of the underlying offender. The CCP can therefore utilise the information provided, along with the trade and cleared level data that it has, to issue buy in notices to the correct party as it does today.

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. We should however note that as per current market practice the field “common reference” can be used for multiple purposes.

In a case where there is no reference in the instruction to identify a trade venue transaction, a CSD would have to inform the respective CSD participant, who in its position as intermediary, would then forward the information down the security chain. The actual trading participant would then receive the information, could then identify this transaction as a trading venue transaction and inform the venue accordingly.

We should note that the above process could be implemented at CSD level with limited additional costs as the provision of fails information already is business as usual.

As highlighted in the introductory comments, we are planning as an industry to complete a workshop by mid June to determine the complex scenarios in implementing a buy in regime (e.g. non- trading venue or CCP-related activity), and put forward possible workable solutions to ESMA.

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

We believe that the requirements set out in paragraph 76 go well beyond the Level 1 text, are unclear, and involve considerable duplication of reporting.

- The level 1 text (Article 9, paragraph 1) requires the reporting of "securities transactions". Paragraph 76 of the ESMA Discussion Paper suggests the reporting of "transfer orders". The difference is very significant. A "transfer order" covers all types of transfers, including portfolio transfers and collateral movements. We believe that "securities transactions" should cover only real purchases and sales.
- Any requirement based on the reporting of "transfer orders" will most probably force all banks in Europe to report, as all banks in Europe will on occasion, and on behalf of retail clients, transfer securities from one account to another. In any event, we suggest a minimum threshold for reporting.
- We believe that Article 9 is not aimed at all banks in Europe, but rather at significant custodians, and other similar professional intermediaries. For such institutions, many of the requirements set out in paragraph 76 for the reporting of procedures to national competent authorities duplicate existing requirements, and existing supervisory practice.
- We believe that the reporting requirements under Article 9 are limited to statistical reporting. Specifically, we suggest that the information reported should be limited to bullet points 1, 2, 3, 5 and 6. We note that custodians and other intermediaries will not know the underlying causes for failed securities transactions, and so will not be able to supply the information mentioned in bullet point 4.
- The timeframe of 5 working days to provide the required aggregated volume and value information, as set forth in the first point of paragraph 76 of the discussion paper is short and AFME members would welcome an extension to 10 days.
- We believe that the settlement of any securities transactions for which securities settlement instructions are sent to an SSS should not be considered internalisation of settlement. This includes the cases where settlement occurs at the CSD between different securities accounts of the same CSD participant, and cases where settlement occurs within the same securities account of the CSD participant at the CSD. The rationale for this exclusion is: (i) information on the securities transaction will be held at the CSD, and will be included in the CSD's reporting to the national competent authority, and (ii) the processing at the CSD (including potentially matching and settlement) will take place under the rules of the CSD.

Considering that settlement internalisation occurs by definition outside of Securities Settlement Systems (SSSs), it will be important to align and reconcile the legal and practical implications deriving from any new legislative proposals for SSSs and for their participants with the activities of entities who are deemed to be carrying out internalisation. In the case of internalised settlements, the same level of investor protection given by SSSs is achieved through the operational and accounting procedures of the bank or custodian, for example through reference to the settlement confirmation (MT548) or the payment confirmation (MT900-910) or the production of an end-of-day statement of transactions, all of which are already common practice and fully regulated under banking laws.

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

AFME agrees that recognition of CSDs should follow the rule of not-discriminating 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.

Q29: What are your views on modality for maintaining and making available such records? How does it impact the current costs of record keeping, in particular with reference to the use of the LEI?

We are interested in the statement that 'ESMA is considering LEI as the code for identifying legal entities under CSDR'. In the consultation this relates to the format for CSD records, which the CSDs will be required to keep.

AFME, via GFMA, has been a long-standing supporter of the LEI and urge global adoption in legislation. It offers regulators and industry an opportunity to standardise and harmonise this important piece of reference data and provides the ability to measure systemic risk. The LEI recently came into force for reporting under EMIR and we anticipate further use under the MiFID review. We have also seen the EBA adopt the LEI as a standard for its reporting.

However, we should highlight that BIC 11 has been agreed as the industry standard for identification, and that any adoption of LEI would need to be based on a comprehensive cost vs. benefit analysis, since every party in the settlement chain would be significantly impacted in order to accommodate this identifier.

Q53: Do you agree with these views? If not, please explain and provide an alternative.

We understood from the public hearing in Paris that EBA will engage and will respond to their consultation paper. However please find attached AFME's position on the issue of separating the provision of CSD core and related services from ancillary banking services in different legal entities.

Q54: What particular types of evidence are most adequate for the purpose of demonstrating that there are no adverse interconnections and risks stemming from combining together the two activities of securities settlement and cash leg settlement in one entity, or from the designation of a banking entity to conduct cash leg settlement?

We understood from the public hearing in Paris that EBA will engage and will respond to their consultation paper. However, please find attached AFME's position on the issue of separating the provision of CSD core and related services from ancillary banking services in different legal entities.

Supporting Documentation (attached separately)

AFME Allocation and Confirmation Automation BPRD 22nd June 2012

AFME Post Trade CSDR Revised Position Separation Paper 11th June 2013