bankenverband

Comments

on ESMA´s discussion paper “Draft Technical Standards for the Regulation on improving securities settlement in the European Union and on central securities depositories (CSD)”

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Introduction

Thank you for the opportunity to comment on ESMA´s thoughts on the technical standards for the CSDR. We will be using the same abbreviations like in the discussion paper “Draft Technical Standards for the Regulation on improving securities settlement in the European Union and on central securities depositories (CSD)” of March 20, 2014 (discussion paper).

The **Association of German Banks** (Bundesverband deutscher Banken (BdB)) is the voice of the private banks in Germany. As a leading trade association, it coordinates, shapes and represents the interests of the private banking industry and acts as a mediator between the private banks, policymakers, administrators, consumers and the business sector. The Association of German Banks comprises more than 200 private banks and 11 regional member associations. We would like to mention that the German CSD, Clearstream Banking AG, as a private bank with a banking licence, is also one of our members. We, therefore, accommodate the – sometimes diverse – interests of both the private banking industry and the CSD.

We have submitted our comments to the German Banking Industry Committee which is our joint committee of the central banking associations in Germany: BVR for the cooperative banks, VÖB for the public-sector banks, DSGV for the savings banks, vdp for the Pfandbrief banks and us for the private commercial banks. We understand that the German Banking Industry Committee will comment on ESMA’s discussion paper including our view. However, given the limited time for the submission, we were asked by the committee to also contribute in parallel our comments directly to ESMA. Therefore, please read the following remarks in conjunction with the statements by the **German Banking Industry Committee**.

We have structured our response into three main sections:

- General remarks,
- Settlement discipline (including general remarks regarding buy-ins),
- Remarks on CSD authorization, safety and reliability.

I. General Remarks

As participants and users of CSDs, our members are very interested in both their regulation and improving securities settlement in the EU in order to guarantee the safe, effective, cost-efficient and reliable functioning of one of their core service providers.

1. Unique role of the CSDs

We believe that we should first point out the unique role that CSDs have in respect of not only the settlement of securities but also in respect of the central safekeeping and custody of securities as well as the over-arching and connecting function as a financial market infrastructure between banks as their users, their clients and customers as well as other financial market infrastructures.

CSDs serve self-contained purposes and their tasks are not reduced to merely the execution of settlement instructions more or less as an annex to CCPs or trading venues. CSDs safekeep paper certificates as well as global notes and maintain registers for dematerialised securities and are thus essential to simplify complicated holding chains and posting procedures in connection with the holding and transfer of securities. They are, furthermore, indispensable for the administration and execution of securities collateral and they stand as a safeguard for the integrity of an issue. Moreover, they keep assets on behalf of investors (even through a chain of sub-custodians) and therefore deal with the transfer of ownership of the securities they safeguard. Unlike CCPs or trading venues who deal with contractual obligations, CSDs handle the legal title and possession of the assets of such underlying obligations. However, in contrast to CCPs or trading venues whose activities are trade-based, CSDs are **not** involved in the trading of financial instruments. This distinction is an important one, particularly in regard to the discussion of how settlement fails are to be treated.

Following the development of the CSDR in some parts, we perceived with some concern that a few of the CSD tasks which are crucial, including the different account-holding models and the mechanisms how CSDs carry out their work, were commingled with the tasks and mechanism of other infrastructures like, for instance, CCPs.

2. Adequate regulation

Given the unique role of CSDs, their regulation should be tailored for them or at least accommodate their role, risk profile and services adequately. We would like to encourage ESMA to reference the technical standards to the CPSS-IOSCO Principles for Financial Market Infrastructures (PFMI) in order to ensure consistency with global standards for CSDs. We would like to point out that the co-legislators produced the CSDR inter alia for the sake of compliance with the PFMI, thus level 2 should mirror the same approach, particularly in respect of general business management, risk management and settlement.

Although we believe that it can be beneficial to adapt certain definitions or provisions from other pieces of legislation and regulation in order to ensure consistency, we also clearly see a **danger of blueprinting** complete systems or mechanisms that do not take into account the specificities of CSDs and will therefore lead to adverse results.

The regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR), for instance, considers the role, services and mechanisms of CCPs, which are comparable with CSDs, if at all, only in a very limited way.

For the benefit of the clients and customers of our members and also for the sake of our members' own assets, any custodian, and particularly the CSD, has to work as a safe and reliable depository who not only safeguards but also administers the securities that it is entrusted with. Those assets must hence be unequivocally insolvency-remote in case of a crisis of the custodian. On the other hand, markets are dependent on the quick functioning of settlement instructions in order to fulfill contractual obligations.

Therefore, in many member states, including Germany, the system of omnibus account holding has been established. It guarantees (at least this is the case in Germany) the insolvency-remoteness of all assets the custodian holds for its clients, while allowing the quick, safe and reliable transfer of securities even through long chains of sub-custodians. The collective safe custody of securities in omnibus account structures was created in order to serve the needs of high-volume business and to simplify securities safekeeping in general without compromising any legal aspects. Any additional segregation of securities at the level of each (sub-)custodian and at the level of the CSD will, however, lead to a multiplication and complexity of securities accounts. This would make account reconciliation and the bookkeeping process more complicated and time-consuming, because fewer transactions can be netted, and could give rise to a greater likelihood of incorrect book entries and, therefore, to actual or legal disadvantages for clients.

What is important from the client´s perspective is not the multiplication of individual accounts but that custodians segregate their own assets from those belonging to other parties. In fact, access to assets held in collective safe custody in omnibus accounts does not require individual segregation. It is also unclear – especially in the case of cross-border chains of custodians – how the relevant accounting chain is supposed to be maintained. Moreover, this complex form of account-keeping may well be more prone to errors.

We recognized with some surprise that namely the account segregation in Article 38 CSDR lead to a comparison of apples and oranges. We would, therefore, like to take this as an example that EMIR cannot be the model for the CSDR – neither for level 1 **nor for level 2**.

In contrast to Article 39 EMIR, where the segregation of contractual obligations of a customer with regard to a CCP leads to the advantage of insolvency-remoteness of these obligations and therefore to more security, Article 38 CSDR may well lead to the opposite result when clients of a CSD participant opt for the segregation of their assets. We would like to point out that securities are not contractual claims that can simply be eliminated by, for example, being netted. Even if a CSD participant becomes insolvent, its client is not adversely affected – unlike the client of a CCP – because its ownership rights to its securities are not impaired, whereas the claims of a CCP clearing member's client as contractual obligations are converted into insolvency claims. The relationship between a CSD participant and its client is, from a legal and economical perspective, quite different from the relationship between a CCP clearing member and its client.

This example shows that the adaption of provisions that are reasonable in respect of a certain market participant or financial market infrastructure to another does not necessarily enhance transparency and certainly does not improve security – if anything, the opposite is the case.

Although ESMA is not called upon to draft technical standards on the issue of account segregation, we would nevertheless like to express our concern that undesirable results can be created if inappropriate provisions – EMIR in this case – serve as the model for the regulation of CSDs. We are confident that ESMA will acknowledge the specificities and distinctiveness of the CSDs as well as their important role when drafting the technical standards.

3. Outlook

We are aware that harmonisation of securities settlement within the EU will involve a lot of change regarding the working process, including IT systems, book-keeping and posting procedures as well as a substantial amount of work especially with respect to the implementation of the T2S project in parallel.

We are confident that ESMA will “not fix what is not broken” and will carefully and prudently balance the tried and tested working streams and methods against new envisaged ideas for improvement so that especially the settlement efficiency will not suffer from new provisions which will then turn out to be disruptive. We hope our remarks can be of help for the technical standards.

Please find our further comments directly on ESMA´s questions below:

II. Settlement discipline

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?

We support ESMA’s approach to enhance settlement efficiency. One precondition for this relates to early confirmation of trades and the early allocation of so-called block-transactions, i.e. where a fund manager gives a large order for a number of funds under his management and upon trade confirmation provides the broker with the breakdown of the underlying funds. Ideally, both activities are performed with a close time connection.
ESMA should take into account the solutions already used by the markets. In this context, we note that several electronic standards already exist which ESMA could base its work on. Fields relevant for the subsequent matching at the level of the CSD should be included in the confirmation. Additionally, the SWIFT MT 515 should give the right orientation as well as the matching rules developed within T2S. Today the mandatory matching fields vary slightly between the (local) markets, which reflect the needs of the specific markets. This should be taken into account when defining the necessary common elements; differences between local markets shall not automatically be mistaken as a barrier for an integrated European market.

Electronic communication is preferred for the communication between the investment firms and their clients, although other options should not be excluded but kept on a minimum scale.

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.

We absolutely support ESMA's view, that automated procedures should be the rule for the settlement instructions on CSD level. Nevertheless manual intervention is nowadays a well-known tool to actually enhance settlement efficiency. This is not just to correct little mismatches within the instructions, such as small cash amount mismatches or changes in the delivery instruction. Manual intervention can also be necessary in processing of specific corporate actions and primary market transactions. This should be considered when setting the standards. Moreover, it could be considered as an alternative communication channel in case of any communication disruptions (Fall Back Scenario/Business Continuity Measures).

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

We support the ISO format, but do not see the need to set this as a standard for the whole market. T2S rules, for example, acknowledge current market practice and allow coexistence of specific ISO standards - ISO 20022 for communication between T2S and CSDs, ISO 15022 for the communication between CSD and CSD participants. An ESMA standard for the CSD level (between CSDs and their clients) can be supported, but should be flexible enough to allow current wide market practice without limiting future developments. We therefore recommend not to refer to a specific ISO standard.

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?

We again share ESMA's view that matching is a precondition to gain high settlement efficiency. Nevertheless, for specific reasons settlement should also be possible without matching (in the securities settlement system):

(a) when instructions have already been matched by a trading venue or a CCP and are received by the CSD via a trade feed;

(b) in case of corporate actions processing;

(c) for other transfers such as accounts belonging to the same custodian/ CSD participant.

ESMA should be aware that the settlement system is not the only place where matching can take place and the settlement of instructions – like the transfers between custodians – can already have been matched elsewhere. We therefore suggest that exemptions from matching should also be possible for the different markets where it is needed, without assuming a market failure.

Paragraph 16 seems to be very specifically asking for matching "continuously throughout the day". When drafting the standards we would recommend a somewhat wider approach that considers matching in near time (batches), too. This standard works in Germany very well and leads to high settlement efficiency. Therefore we do not see the need for a European standard to go beyond it.

To include client codes only optionally is sufficient in our view. Matching without this code should be possible for each side of the transaction to ensure that the transaction does not fail.

Also here we would like to refer again to the T2S standards as minimum standards.

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?

Although we generally support early matching as an incentive for timely settlement, we would like to point out that a high rate of matching efficiency does not necessarily translate into a proportionally lower rate of settlement fails, meaning that early matched transactions can still fail in settlement and late matched transactions can still be settled in time. An ECSDA statistical exercise of 2012[1] shows that no direct correlation between the matching rate of a certain date and the settlement efficiency rate on the intended settlement date can be made.

As also stated in our general remarks regarding buy-ins below, we would like to point out that different matching systems and mechanisms are in place today and that different types of participants have different possibilities to provide early matching. Matching can also take place outside the securities settlement systems (SSS) of the CSDs (see Q4).

This should be taken into account particularly in connection with para. 23 of the discussion paper. Matching and netting at CCP level, for example, are considered to be more efficient when using the so-called "actual settlement day netting"-system (ASDN) – like that of the German CCP, Eurex Clearing – or the so-called "continuous net settlement" (CNS). All open settlement instructions can be cancelled by the CCP at the end of the business day of the CCP in these systems in order to be netted as new instructions that come in to the CCP on the next business day. This mechanism was introduced in 2003 and has been working successfully ever since. The advantage of these systems is that matching and netting of the settlement instructions can take place continuously without leaving behind open settlement instructions at the level of the CSD, which is especially helpful for low-liquid or illiquid products. Participants have the choice between

[1] ECSDA 2012 Statistical Exercise on Matching and Settlement Efficiency of September 2012

different netting models including the “trade day netting” (TDN) system described in para. 23 of the discussion paper. All these options should continue to remain possible.

If the CCP were to be forced to modify its matching and netting systems to only TDN, many CCP and CSD participants will be negatively affected. Furthermore, a change of this system would also imply major changes for T2S at this considerably late stage, which should be avoided as no substantial justification is evident. Given the limited time for submission of the comments on the discussion paper, no figures for the estimated costs for a change could be identified yet. We will gladly deliver these at a later stage if ESMA is interested.

We wonder if the proposed system of disincentives - which gives a quite complex impression - is necessary at all. Instead, we would recommend ESMA to follow a two-step approach. First, ESMA could analyse how much EU-wide settlement efficiency is improved following the new ESMA standards for confirmation, allocation and matching. If the achieved EU-wide settlement efficiency is not satisfactory – which we do not expect since high efficiency in the German market is also achieved without comparable disincentives - in a second step additional measures like these could be considered.

Moreover, the point in time described in para. 23 when disincentives apply, i.e. where settlement instructions are not received by the end of “ISD-2”, is far too early. In a t+2 market like Germany this would mean that disincentives start already on the “intended settlement day minus two”, that means t=0, which is the trading day. This cannot be intended and moreover seems to neglect differences in time zones completely. Transactions matched by ISD-1 can still settle in the night processing for ISD, which starts after cob of ISD-1. In T2S the most efficient time for transactions to settle is the overnight batch; for this the instructions should have matched in T2S by the end of ISD-1. Matching earlier than ISD-1 would not bring any additional value, but may put an unnecessary burden on market participants. Furthermore, it would not be possible for bilateral transactions which are to be delivered t+0 or t+1. We are not only concerned by the administrative burden but also the cost aspect of “disincentives". CSDs will have to adapt their systems and costs will increase for participants in general.

In para. 24 we support the idea to inform participants about pending settlement instructions across all European markets. Here we expect major improvements with the introduction of T2S and corresponding rules. Hold and release facilities mean that transactions are blocked on ISD in order to avoid securities being delivered from omnibus accounts which are reserved or restricted for other transactions.

Para. 25 is favoured by the German market as information about pending settlement instructions will likely enforce efficiency. The timing of such information should be left to the needs of the participants of the CSD, but the information should be available at least once after the first matching attempt by the CSD and once at the beginning of the ISD.

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.

We agree with the described system functionalities and ESMA's opinion in para. 29 that CSDs should offer at least three daily settlements (batches) if no near-time/continuous settlement is offered and regard it to already be the status quo. Nevertheless, problems are encountered in a cross-CSD context today where CSD processing cycles are not synchronised and a transaction can fail if it is received too late in a specific cycle and therefore cannot be delivered onward until the following business day. Last but not least, we wonder if this is part of the requested technical standards ESMA shall provide due to the CSDR.

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 support ESMA in its view that optimization, partial and recycling are useful tools to be applied by CSDs. The function of shaping trades is common for CCPs, but not usual for CSDs since this leads to higher settlement costs if trades are split up into an unforeseeable number of smaller instructions. So as not to risk a fail of a whole trade/instruction, it seems sufficient to achieve high efficiency by allowing partial settlement.

In addition we share ESMA's view that there are other system functionalities that enhance settlement efficiency.

To optimize settlement a "Linkage"-function would be desirable as this functionality ensures that settlement systems will only settle flagged transactions if the "linking condition" (i.e. in T2S: WITH, BEFO, AFTE) is fulfilled.

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 support CESR-ESCB Rec. 5 for SSS and ESMA's view that lending facilities in a market can improve settlement efficiency. However, those should not be mandatory for CSDs to offer. If the CSD offers a lending facility, it is of the upmost importance that the CSD itself acts only as an agent and not as a principal in lending to avoid risks arising from this function. The transaction-related explicit consent of the borrower is a necessary prerequisite in our understanding.

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 support ESMA's described system to monitor settlement fails, which seems to be sufficient.

Moreover, we have only one remark on the required data in para. 41, especially "Type of instrument": here it seems detailed enough to differentiate between shares and bonds; the ISIN-level approach would be too detailed.

Q10: What are your views on the information that participants should receive to monitor fails?
Here we also support ESMA's view that the participants need only the information on their own trades settled/to be settled that have failed or are about to fail. We believe that CSDs should not be required to send such information to their participants, as this may imply sending unnecessary data at an excessive cost, but should rather give their participants access to regular reports on their individual level of settlement fails. A helpful feature of these individual reports is considered to be the "benchmarking", showing the number of settlement fails in comparison to the market (monthly). Participants should be able to decide whether or not to subscribe to such service offerings – which should remain part of contractual arrangements - and therefore have access to the relevant information.

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?
Here we do not ask for a specific format, but would see benefit in a unique one for Europe for such information to be comparable. Nevertheless, detailed information should be disclosed only between CSDs and their participants and not to the public.

Q12: What would the cost implication for CSDs to report fails to their competent authorities on a daily basis be?
No comment.

General remarks regarding buy-ins
Regarding the buy-in procedure, we would like to point to the difficulties posed by the creation of a standard procedure for CSDs and trading venues as well as its timely implementation. In view of the fact that no established standards exist as of today that can stand as a model for a new buy-in regime, we see the need for an **in-depth discussion** among market participants about the details of possible future models and different solutions. We would like to invite ESMA to facilitate such discussion and make use of **phase-in periods** to ensure a smooth implementation and application of new standards.

1. Timing

Timing will be of the essence for a new settlement discipline regime, particularly with respect to the parallel implementation of T2S. Please take note of the enclosed multi-associations' letter of the European Banking Federation (EBF), European Central Securities Depositories Association (ECSDA), European Savings Banks Group (ESBG), European Association of CCP Clearing Houses

(EACH), International Capital Market Association (ICMA) and ICMA European Repo Council (ERC)[2] in which the challenges of these new tasks and proceedings are laid out.

Apart from the T2S project, which should ensure a harmonised regime for settlement discipline, we urge ESMA to take into account phase-in periods for the implementation of new provisions regarding settlement discipline. In contrast to CCP clearing, where rules for buy-in procedures exist (including procedures for Article 15 SSR), there are no such rules for trading venues and CSDs as of today (see also II.2 below).

However, considering the high settlement efficiency, measures for a new settlement discipline regime need to be practical, proportionate and time-appropriate in order to further enhance it. Settlement efficiency has been monitored well throughout the past years. According to an ECSDA statistical exercise[3], "settlement efficiency is generally high across all European markets, with a settlement fail rate of around 1.1% in terms of value, and less than 0.5% on the day after the intended settlement date".

The results of the statistical exercise show the following settlement efficiency for Germany:
On the intended settlement date (ISD), 99.38% in respect of value and 95.40% in respect of volume vis-à-vis 99.91% in respect of value and 98.80% of volume on the next business day (ISD+1)[4].
According to our members, the settlement efficiency on ISD+4 is close to 100%, meaning that only very few transactions per month need to be bought in (for CCP-cleared transactions and transactions executed on trading venues, buy-ins are executed in the low single-digit range per month per member).

Given the above-mentioned figures on settlement efficiency, the provisions on buy-in procedures will affect less than 0.5% of all settlements. We thus rely on ESMA not "cracking a nut with a sledgehammer". Any measures which do not build on established systems or substantial changes to them can result in the opposite of what is envisaged. Any hasty, premature implementation may result in CSDs not being compliant with CSDR – which would be a disaster for settlement in the EU and should be avoided under all circumstances.

2. New rules for buy-in procedures

In order to be least disruptive for settlement efficiency, we would like to suggest building upon established procedures for a buy-in as far as they exist. We would therefore like to propose **an in-depth discussion among the market participants (CSDs and participants)**.

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[2] Letter of November 4, 2013 to the co-legislators of the CSDR

[3] ECSDA 2012 Statistical Exercise on Matching and Settlement Efficiency of September 2012, p.5

[4] ECSDA 2012 Statistical Exercise on Matching and Settlement Efficiency of September 2012, p. 7

i) CCPs

With regard to CCPs, our suggestion is to allow CCPs to keep their established buy-in procedures. Although Article 15 Short Selling Regulation will be deleted by Article 72a CSDR and the replacement by Article 7 para. 10 a) CSDR including the respective RTS can take some time, CCPs should continue to work with the same buy-in procedures that are already familiar to the clearing members and clients.

For Germany this would mean an auction process by the CCP after the extension period (see also Q14). We understand Article 7 para. 10 a) CSDR to mean that CCPs will execute the buy-ins themselves and remain responsible also in respect of the cash compensation provided for in Article 7 para. 7 CSDR. A split of this mechanism and responsibility of another institution for the cash compensation does not seem reasonable and intended. Clarification could be of help.

ii) Trading venues

In contrast to the CCPs, trading venues are not parties to the trades that are executed on them. Today, trading venues may have rules for the settlement of trades, but usually no rules exist for settlement fails or buy-ins. Trading venues do not execute buy-ins either. They provide a platform to match buy and sell orders. Although some trading venues send settlement instructions directly to CSDs, some others may leave this to their participants. Hence, trading venues usually do not have information about settlement fails. Therefore, it is the buyer´s responsibility to execute a buy-in.

As trading venues offer a transaction platform for the product which produces a settlement fail, a buy-in will generally be more likely to be successful than in a bilateral transaction. However, the situation and the risks and responsibilities are comparable to bilateral transactions (see below).

iii) CSDs

Like trading venues and unlike CCPs, CSDs are not parties to trades. Furthermore, unlike CCPs and trading venues, CSDs are not involved in the trading of the financial instruments. They receive settlement instructions from their participants, who also are not necessarily parties to the trade of the settlement instruction. These instructions typically consist of the matching fields described in para. 18 of the discussion paper. The CSD has no knowledge of the ultimate party to the trade nor of the specific type of transaction. In many cases, the CSD is not even aware if the trade was concluded on a trading venue.

Given these procedures, the CSD is not in a position to execute a buy-in. A cautious approach to the future buy-in procedure for bilateral transactions needs to be taken in our opinion.

As of today, it is up to the buyer to initiate the buy-in procedure, which will usually take place after several warnings to the seller. The buyer appoints the buy-in agent. Any new rules for buy-in procedures should provide for the same responsibilities and avoid a different allocation of risks. It should be up to the buyer to determine who the buy-in agent should be, although several solutions are possible. The measures on how to ensure that the buy-in is actually executed will be at the centre of the discussions proposed above.

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?

In order to establish a well-functioning, automated and reliable buy-in procedure, we support the idea that the extension period should **generally be four business days**. This would set a clear rule with predictable and reliable consequences. It would also take into account the fact that a four-business-day period is already market practice as of today under Article 15 Short Selling Regulation (SSR), which will be substituted by Article 7 CSDR.

Asset type and liquidity should, therefore, be taken into account **only for exceptional circumstances** which justify lengthening the extension period beyond four business days. Liquidity should not be the only aspect but always one among others that ESMA will look at when determining which exemptions will apply to the rule of four business days. Liquidity should, furthermore, only be taken into account when it relates to the financial instrument itself rather than to a certain market. Specificities of a market are already considered by CSDR level 1 as regards SME growth markets and should thus not form the basis for more exemptions. We believe that any exception to a rule can lead to confusion, difficulties in delineation and potentially unfair results.

When determining the liquidity or illiquidity of a financial instrument, we support ESMA´s approach to take into account the criteria for assessing liquidity under Article 2 para. 1 (7a) MiFIR. However, our understanding is that the criteria for assessing liquidity will only classify products into liquid or illiquid categories, but not sub-divide these into groups of illiquidity. Hence, further questions may arise in connection with lengthening of the extension periods: what kind of illiquidity will justify how many more business days for the extra-extension? How often will the extra-extension days be adjusted to a (significant?) change in (il)liquidity? Will historical data on liquidity be taken into account although it may not be justified for certain asset types like bonds?

For the time being, it is still unclear what kind of liquidity will be considered by ESMA under MiFIR:

- the liquidity in an ISIN or asset type for one (domestic) market or for the EU or globally?
- How granular will the criteria be?

These questions could be followed by:

- How are the participants to be informed about any change of parameters?
- What happens if a change occurs during the extension period, especially with the result of a shortening or lengthening of the extension period?

- Will there be a phase-in period?
- What does the obligation to monitor parameters look like?

Article 2 para. 1 (14) CSDR defines a settlement fail as "the non-occurrence of settlement or only partial settlement of a securities transaction on the intended settlement date, due to a lack of securities or cash regardless of the underlying cause". We would, however, like to point out the various causes that can lead to such settlement fail which are still likely to be delivered within the four-day extension period:

- Differences in time zones and business days
  Trading or settlement partners can be located in different time zones and countries with different business days. Time zones in Asia or America can diminish the time necessary for the matching of settlement instructions. This is even more the case for (cross-border) settlement than for trading.

- Difficulties in the matching process for settlement instructions
  In markets without fixed rules for settlement, details for the settlement instructions need to be agreed upon among the involved parties; this can take some time. Additionally, the longer the chain of involved parties for a settlement is the more time will be consumed. An example: an asset manager sends a trading instruction which needs to be allocated and confirmed before the settlement instruction can be sent. This can be transported through a chain of custodians (investment company for several accounts-depositary bank-global custodian-sub-custodian and so on). Mismatches can occur which need to be clarified by telephone.

- Cross-border settlement, unequal settlement batches
  The failing participant needs to deliver a product on the intended settlement date. The failing participant wants to deliver the product from a purchase that is also due on the same intended settlement date. The failing participant is expecting the product from his counterparty who delivers in a late batch on the intended settlement date. However, although the settlement of the product takes place in time, the delivery is too late for the last batch in order to forward the product to the receiving participant for settlement.

- Different settlement cycles
  A failing participant is obliged to deliver a product within t+2. However, on the trade date he has bought the product in a market with a longer settlement cycle, for example t+3 or more. Markets outside the EU will continue to have other settlement cycles than in the CSDR. The same applies to transactions within the EU which are not executed on a trading venue. In order to ensure a timely settlement, the failing participant will borrow the product from another party. If settlement for the borrowed product does not take place in time, the obligation to deliver usually is cancelled; settlement can take place with either the original product from a longer settlement cycle or another (newly) borrowed product.

- Client changes trading or settlement partner
  Whenever a client decides to change to a new trading or settlement partner, for instance a new custodian or a new broker, the current securities settlement instructions need to be adjusted with the new partner and other involved parties. Depending on the remaining time for the settlement of a certain transaction, the general and specific requirements cannot always be installed in time.

- Chain fails:
  A participant expects receipt of a product in order to settle a delivery obligation of its own. Ifthis receipt does not settle in time, irrespective of the cause, the onward delivery will fail as well.

A considerable amount of the above-mentioned technical problems should be eliminated once the harmonisation of the settlement cycle T+2 according to Article 5 para.Para.para.2 CSDR is in place. Therefore, we are expecting the effect of enhanced settlement efficiency within the EU just by harmonisation of the settlement cycle. For this reason, we would like to invite ESMA to consider the monitoring and evaluation of all effects of T+2 and T2S after their implementation. The same applies to the period in which Article 15 SSR is substituted by Article 7 CSDR but the technical standards for the settlement discipline regime have not yet come into force. We deem this period a good opportunity to observe the effects of the buy-in procedures from Article 15 SSR as we are convinced that these will not change while no legal provision is in force for a certain time. The positive effects as well as the difficulties created by Article 15 SSR can be considered and corrected in connection with the implementation of the technical standards for Article 7 CSDR.

Therefore, exemptions to the four-day-period-rule in respect to short sales should only be made where the experience in connection with Article 15 SSR has shown considerable difficulties or where other exceptional circumstances apply. We are of the opinion, though, that a market maker should take into account the risk of producing a settlement fail when making his quotes.

Additionally, any longer extension period should be clear and predictable and not subject to continuous changes or adjustments.

Such longer periods could be considered for the following asset types:

- ETFs,
- UCITs (which may, however be admitted to trading in other markets),
- Fixed-income instruments like bonds, convertible bonds or structured finance products.

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?

1. Need to specify other minimum requirements:

While we also see the need for the notices mentioned in para. 54 of the discussion paper to be sent to the "concerned parties", we would like to mention that it will be difficult to proceed in this way. We would like to point out that CSDs only receive settlement instructions from their participants (see also II. above). As these instructions do not contain details of the trade or of the parties to the transaction, the notices cannot be delivered to the "concerned parties" of the buy-in as designated in para. 54, but only to CSD participants.

In connection with the requirements listed in para. 54 of the discussion paper, we deem it necessary that any method or mechanism for the execution of the buy-in should not contain any additional risk for the CSD.

Our members support, therefore, ESMA´s approach that it should be left to the CSD to decide not only on the buy-in feasibility but also on the method for the execution of a buy-in. Our suggestion is to reflect today´s practice. Discussions should include the issue of whether and how CSDs should be entitled to receive the details of a transaction in order to send the notices (information of the activation, start of the buy-in and result of the buy-in) through their participants to the concerned parties.

The buyer may want to have the buy-in executed by a CCP – as an agent – in an auction in order to reach out for the highest number of possible sellers and the lowest buy-in costs. The buyer may, on the other hand, want to appoint a certain buy-in agent where he finds the possibility of a successful buy-in most probable. Consequently, the discussions should also work on possible solutions as to how the execution of the buy-in can be ensured. This discussion should also comprise the question of which other minimum requirements are needed for an appropriate buy-in mechanism (like the dispute of a buy-in for unmatched transactions or aspects of disproportionality of a buy-in, e.g. transfer of securities from one account to another of the same ultimate customer or retail FoP transactions).

Moreover, the CSD is not in a position to actively instruct other parties. A CSD receives instructions and executes such instructions. In the case of a buy-in, the concerned parties will – and according to the future internal rules of the CSD must be obliged to – cancel the original settlement instructions and replace them with the settlement instructions for the buy-in. The concerned parties, i.e. the buyer, will appoint a buy-in agent, CCP (if possible) or other person in charge of the buy-in and change the settlement instructions accordingly. The buy-in agent will deliver the financial instruments instead of the former seller to the buyer. The buyer will pay his purchase price to the buy-in agent and will be reimbursed for the costs of the buy-in by the (former) seller. The CSD does not get involved in the buy-in itself. Discussions on a new buy-in regime should reflect on this and provide for the minimum requirements of all parties involved.

2. Length of buy-in mechanism:

As regards the second question of Q14, we would like to point out that there is no definition of the term “execution period”. This term can be understood in different ways:

a) If “execution period” is to be understood as the timeline for the settlement of the financial instrument once the buy-in (auction) was successful and settlement can positively take place (i.e. the auction process is closed or the buy-in is confirmed): The period for the delivery of the instrument should be very short and should take place within one business day.

b) It could also be understood as the time starting after the extension period has elapsed until delivery of the financial instrument. Regarding the fact that the settlement has been failing for four days or more – depending on the respective extension period – this timeline should ideally be rather short. The appropriate timeline will, however, depend on the concrete buy-in mechanism, the liquidity of the financial instrument and on the question of how many times the buy-in can be attempted. The more liquid the financial instrument is, the shorter the appropriate timeline should be. Experience has shown that an unsuccessful buy-in attempt will not be successful in further attempts.

As a guideline, the buy-in mechanisms executed according to CCP rules nowadays in Germany are as follows:

- Execution is on business day 5 (Article 15 SSR) or another set date, delivery is next day (overnight),
- one central buy-in “unit” at CCP for the market,
- usually by auction.

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 to be considered not possible

We support ESMA´s approach that it should be left to each CCP, trading venue or CSD to decide on the buy-in feasibility. We understand that the decision that “should be preceded of competent authorities approval” refers to the general decision in the internal rules of the CCP, trading venue or CSD and not to each single decision taken for every buy-in executed, which would be very cumbersome. Clarification in this respect would be of help.

A buy-in is not possible for reasons that lie in financial instrument, such as:

- Financial instrument is not transferable,
- Product is unique or especially structured for a specific transaction,
- Financial instrument has ceased to exist (for example: after maturity or physically destroyed),

- after a certain number of unsuccessful buy-in attempts (subject to the proposed discussion on buy-in procedures),
- Particular events that affect the price of the product extraordinarily.

b) Multiple buy-ins

Generally, we support the idea that the RTS should coordinate multiple buy-ins. However, multiple buy-ins may occur for several reasons and several interests may be involved to oppose a coordination:

a) Several fails for the same product occur, but fails are not connected with each other: multiple buy-ins by way of one auction process may be useful and more successful than separate buy-in orders and may also reduce the overall costs of the buy-ins. However, this should only be envisaged if the advantages can be achieved and no conflict of other interests exists. Otherwise, separate buy-in orders should remain possible. The RTS could suggest that multiple buy-ins at the same buy-in agent may be combined and coordinated by way of auction whenever possible and beneficial for all concerned parties.

b) Several fails occur for the same product due to a chain fail:
The RTS could consider for these fails not to be executed in a multiple buy-in order. In domestic cases, the CSD should be in a position to detect chain fails as the CSD can track the open settlement orders of the same product. In this case, multiple buy-ins would not be necessary and would, additionally, create superfluous costs. Quite the contrary, one buy-in could be used in order to settle all other consecutive fails in the chain. Consequently and ideally, the costs of the buy-in should be borne only once by the ultimate fail causer, whereas the other members of the chain should be free of costs. In such a scenario, the party initiating the buy-in and the party causing the fail have typically not traded with each other initially. Clarification should be made that it is possible to forward (pass on) buy-in costs through the intermediary chain.

However, cross-border chain fails may cause problems because the ultimate fail causer cannot be detected. In a cross-border transaction, the CSD only sees the information from the domestic market and not the whole chain. The desirable result, to satisfy all fails in the chain with one buy-in, may therefore not be achievable in cross-border chain fails.

Q16: In which circumstances would you deem a buy-in to be ineffective?

1. Time-frame

We agree with ESMA on the short time frame for operations consisting of several transactions. Where the forward leg is due within the time until the second business day after the expiration of the extension period, the buy-in will be deemed to be ineffective.

This is particularly the case for repo and securities lending/borrowing transactions.

2. Types of Operations

Repo and securities lending/borrowing transactions typically consist of at least two transactions and involve two legs for the settlement of a financial instrument. Many of these operations are short term. Another similar type of operation is a sell/buy-back arrangement and margin lending according to Article 272 para. 3 CRR.

However, even where the timeframe for the forward leg is longer than two business days after the expiration of the extension period, resulting 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 unnecessary and, therefore, ineffective.

Today the following standard agreements could be taken into account:

- European Master Agreement for repos, securities lending and derivate transactions,
- Global Master Repurchase Agreement (GMRA),Global Master Securities Lending Agreement (GMSLA) and credit support annex of ISDA master agreements,
- German master agreements for repos, securities lending and derivate transactions,
- For repos executed on trading venues, the respective internal rules, e.g. Eurex Repo rules in connection with Eurex Clearing rules.

In case ESMA sees no option to consider these operations as cases where the buy-in is deemed ineffective, the parties to the transaction must be bound to bilaterally cancel their settlement instructions. It would, however, be more practical if the above-mentioned standard agreements were considered as an exemption to a buy-in.

It should be borne in mind that a buy-in will be rendered ineffective only for the first leg of the transaction whereas a buy-in for the non-delivery or late delivery of the far leg of the transaction is not ineffective.

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

1. Proposed approach

We support the proposed approach, with the exception of CCP-cleared transactions (see below). The approach stipulates special rules in combination and connection with a buy-in and seeks commensurate compensation if a buy-in is not possible or successful. We agree that the cash compensation should only be due according to para. 62 of the discussion paper.

It needs to be clear, however, that the CSDR and its technical standards are not trying to harmonise national compensation law in the EU, which should remain unchanged in the respective member states.

2. Reference price

For CCP-cleared transactions, the tried and tested rules of the CCP should be taken into account. These rules provide for the consideration of volatile markets and try to avoid economic disadvantages for the buyer. The rules consider previous prices as well as future market trends in order to allow for higher prices at the time of a later acquisition by the buyer. They are long-standing and supported by the market participants.

For all other transactions, we support ESMA´s approach, especially that more than one pricing source should be available for OTC transactions.

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 are well aware of the fact that Article 7 para. 9 CSDR gives an opportunity/imposes an obligation for CCPs, CSDs and trading venues to establish procedures that enable them to suspend any participant that fails consistently and systematically to deliver financial instruments.

However, we would like to point out that the participant is not necessarily the party that caused the fails. Usually, the person causing the fail is a client of a participant or a client of a client and the reasons for fails can vary (see also II. and Q13 above).

We would therefore support the idea that the respective financial market infrastructure (FMI) will not suspend the failing participant itself but will, instead, leave this decision to its competent authority and will reflect this mechanism in its internal rules. This approach could also be beneficial in order to avoid market disruptions. Otherwise, other sellers and buyers who rely on the participant to be suspended could be adversely affected although the actual offender is to be sought elsewhere. The conditions set out by ESMA in the RTS will serve as a basis for the FMI to inform the respective competent authority about the failing participant and further circumstances.

Having said this, we would like to express no opposition to Article 7 para. 9 CSDR but still to propose additional consideration that – in view of the significant consequences of a suspension for the market - ESMA´s approach taken in para. 64 to 66 of the discussion paper could work as a first condition to send out a warning to the participant that the FMI will inform its competent authority. After notification, the competent authority can further investigate the reasons for the fails, the clients or clients of clients responsible for the fails and can handle the decision on whether or not the participant is to be suspended (by the CSD, if necessary) flexibly.

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

In order to avoid that a few large settlement fails may cause the threshold to be fulfilled, both thresholds (volume and value) should be combined. We support, however, the idea that the level of fails should be weighed on the basis of each participant's own activity.

In respect of the percentages and months of the thresholds we would like to propose a settlement efficiency of less than 75% within one year.

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 out-lined above? If not, please explain what alternative solutions might be used to achieve the same results.

1. Information

- CCP transactions

The CCP is a party to the trade and will, therefore, send settlement instructions to the CSD. The CCP needs the information that a certain settlement instruction has failed. The CCP will be in a position to execute the buy-in.

- Transactions at trading venues

The trading venue is not a party to the trade and may send settlement instructions or may have its participants send such instructions. Therefore, the trading venue needs information on the occurrence of a settlement fail and details regarding the trade and the identity of the concerned parties. However, apart from the fact that the CSD may not be in a position to deliver information on trade details, the CSD may not even be aware of the fact that the settlement fail was executed on a trading venue. This is only the case if the settlement instructions were accompanied by a trading reference.

As mentioned in II.2.iii) above, settlement instructions contain the following transaction codes:

- RVP – Receipt versus payment
- DVP – Delivery versus payment
- DF – Delivery free of payment and
- RF – Receipt free of payment

and further details as mentioned in para. 18 of the discussion paper. No other details are received by the CSD and can therefore also not be forwarded to the trading venue.

2. Account segregation

We do not at all agree with the approach that Article 7 para. 14 (h) CSDR imposes an obligation to open a segregated account for any one. Such an approach is a clear contradiction to the wording of Article 7 para. 14 (h) and 38 CSDR. While the former Article entitles ESMA to specify the necessary settlement information, the latter provides for the conditions for account segregation. **Under no circumstances does Article 7 CSDR serve as a mandate to invent a direct holding account model by way of account segregation.** Please also see our remarks regarding our concerns about individual client segregation in the introduction I.2 above.

3. Alternative solutions

One solution could be to have mandatory trade references. This is, however, not envisaged as a matching criterion under T2S. Another solution could be that the trading venue sends the settlement instructions directly to the CSD, as is the case, for instance, in XETRA. Instructions are sent via the LION system and trades can be identified in case of a settlement fail. This would already be covered by Article 53 CSDR.

Comments on penalties:
Although ESMA expects that it will consult on those aspects at a later stage, we would, however, like to mention the importance of rules on penalties going hand in hand with the other rules on settlement discipline, such as buy-ins. This is particularly true for the collection of penalty payments. In case of netting at CCP level, for instance, CSDs should be entitled to delegate the right to collect penalties to the CCP. Furthermore, the different solutions as to where the penalties go and how they are to be distributed needs a comprehensive approach taking into account also the discussions that have been held on this issue in the past. At least the German CSD and its participants have had such discussions.

Q21: Would you agree that the above mentioned requirements are appropriate?
Our members acknowledge the fact that internalised settlements should be reported as regards aggregated volume and value and some further information. Our understanding is that this reporting requirement should translate into a collection of data in order to monitor the risks that may be involved with internalised settlement.

We welcome and support any measures to achieve such transparency. We believe, however, that the measures taken should be proportionate and practical. The data to be collected should be reduced to the minimum data required to receive meaningful and significant information. We would like to make ESMA aware that the list of reporting requirements in para. 76 of the discussion paper will not only be burdensome for many financial institutions but could also be to the detriment of clients and customers.

We agree with the requirement that the aggregated volume and value of all transactions settled outside a securities settlement system should be reported, stating the types of financial instruments (according to the MiFID classification) settled.

When reporting the type of operations, it should be noted, however, that the custodian banks can receive the same settlement instructions sent via standardised SWIFT messages when settling outside an SSS like the instructions sent to an SSS (see II.2.iii and Q 20 above: RVP, DVP, DF, RF). Identification of the type of operation, such as repo, lending, purchase, tri-party arrangement etc., for each financial instrument is not possible and cannot be provided. For the same reason that CSDs cannot provide details of the trade, the settlement internalisers will not be in a position to provide such details either. SWIFT-messages do not differentiate or state the types of operations in trades.

The volume and value of failed transfer orders as well as the underlying causes can be reported on an aggregated basis. The details for the underlying causes are, as stated above, limited to "lack of securities/cash" or "unmatched transaction" because of missing deviating details.

In view of the fact that all transactions are captured, even transactions that are clearly not in the focus of the reporting obligation like cases of volumes or value of unsubstantial importance, a de minimis rule could be considered. This can be implemented by certain thresholds or exemptions. Transactions with retail clients, for instance, which are released on a free of payment basis will otherwise have to be reported, irrespective of their motivation, size or significance, as well as transactions by one and the same client who merely transfers securities from one of his accounts to another at the same bank. It should also be borne in mind that such internal settlement transactions are executed at very low or no cost for the clients. It cannot be precluded for the future, that banks may be unwilling to continue executing such transactions outside of SSS in order to avoid the extensive and onerous reporting obligations or will seek to obtain reimbursement of the costs involved. The client will then be forced to surrender the service of internalised settlement or bear higher costs although the respective reporting is not necessary regarding the rationale of Article 9 CSDR.

Therefore, we would like to suggest revising the list in para. 76 of the discussion paper and narrowing it down to the objectively essential information. This is, in our view:

- Aggregated numbers with regard to volume and value **above a certain threshold**.
- Types of financial instruments according to MiFID classification
- Types of operation according to settlement instructions
- Aggregated volume and value of failed transfer orders
- Underlying causes stating "lack of securities/cash" or "unmatched transaction"
- Static information describing internal settlement procedures

Regarding necessary static information, settlement internalisers could report the facts at the beginning of entry into force of the reporting requirements and thereafter only report any substantial change.

III. CSD authorization, safety and reliability

There are different categories of risks that CSDs may take on:

- Risks stemming from core services (like integrity of the issue, access by issuers and other persons, reconciliation etc.)
- Risks stemming from other, particularly banking services
- Risks stemming from investments and participations and
- Other risks.

Q22: Would you agree that the elements above and included in Annex I are appropriate? If not, please indicate the reasons or provide ESMA with further elements which you find could be included in the draft RTS, and any further details to justify their inclusion.

The information requested seems very extensive. Since participants ultimately bear the cost of a central system like the CSD, we would like to ask ESMA to rely on information already available, e.g. at the level of the national authorities, and avoid any duplication in documentation and proof of it.

Q23: Do you agree that the above mentioned approach is appropriate? If not, please indicate the reasons or provide ESMA with further elements which could be included in the draft ITS.

Yes, this approach seems to be reasonable.

Q24: Do you see other risks and corresponding mitigating measures? Do CSDs presently have participations in legal persons other than CCPs, TRs and trading venues that should be considered? Would banning CSDs from directly participating in CCPs be advisable, in your view?

We would like to suggest a functional approach. The focus should, in our view, lie on the risk that the loss of the CSD in the participation could be higher than the mere loss in value of the participation. We agree with ESMA´s anticipation that under normal circumstances the loss is limited to the decline in the value of the participation. However, there can be circumstances (see below) when the loss is higher than this and additional obligations to pay or contribute (extra) funds can arise.

Mitigating measures – limitation of participation in regulated entities does not seem to be the best solution. The mitigating measure should rather be that, from the participation itself, no loss beyond the value can occur and no contractual or legal obligation can arise to fund money into the participation.

Given the fact that CCPs concentrate a high amount of risk, can be systemically important and the global /European co-legislators are considering CCP loss allocation among creditors and owners, a ban on direct CSD participation seems reasonable to us.

The proposed restrictions would, however, prevent CSDs from participating in ventures which are core to its business functions. Strategic investment must be generally possible even if the target does not provide services listed in CSDR Annex Section A or B. The investment must be of a strategic nature which means that the business of the participation does not necessarily have to be that of a regulated financial entity but must have some connection with the business of the CSD. Hence, participations in entities like data service providers or accounting units or other service providers should generally be possible. The focus in respect of a limitation must lie on the financial risks. This means that it must be clear that the losses of the participation are capped to the value of the participation and must not fall below 0 or amount in obligations to pay or contribute other financial resources.

Therefore, the agreements between the CSD and its participation should be subject to supervision and permission. Any agreements that amount to control as described in para. 94 and 95 of the discussion paper should not be possible. The same applies to profit and loss agreements or any other undertaking agreements according to which the CSD would be obliged to take over the loss of the participation or would receive an obligation to pay. It must be absolutely clear that the CSD cannot take actions to influence the business of the participation. With respect to para 96 of the discussion paper, however, we disagree: the CSD must generally be in a position to provide its core functions without "subsidising" them from any revenues from participations at all. Otherwise, the business case would be wrong. A CSD must be able to run its business without any revenues from participations at all. Therefore, we believe that CSDs may receive and keep revenues from their participations which can increase the CSD´s own revenues. No limitation of revenues is needed. However, CSDs should not rely on and should not be dependent on such participations.

Q25: Do you consider the approach outlined above adequate, in particular as regards the scope and frequency of information provision and the prompt communication of material changes? If not, please indicate the reasons, an appropriate alternative and the associated costs.

It is not clearly understood what is meant by material changes and how detailed the mentioned report to the competent authority should be, so this question seems to be difficult to answer.

In any event, for the annual review of CSD's compliance with CSDR, ESMA should rely as much as possible on information already provided by the CSD. ESMA should only require CSDs to provide information where such information is not yet available to the competent authorities. Moreover, ESMA should replace any previous reviews carried out using the ESCB-CESR framework by the newly introduced annual review proposed under Article 22 of CSDR that is to be defined.

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

We believe that third-country CSDs should at least comply with the CPSS-IOSCO PFMI as a prerequisite.

If this is the case, the approach taken by ESMA seems reasonable to us, provided that follow-up arrangements will be developed to ensure that once a third-country CSD has been recognised, it will continue meeting the EU supervision requirements and equivalence over time.

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?

1. Sound and prudent management of the CSD

Yes, the responsibilities and reporting lines described appropriately reflect sound and prudent management of the CSD. These responsibilities and reporting lines will always also be part of EU or national corporate and regulatory law, which should also be reflected upon by ESMA. Duplications and inconsistencies between different sets of requirements should be avoided.

2. Further conflicts of interest specified

No comment.

3. Audit report or findings

As all members of the user committee are bound to a non-disclosure obligation, the audit report should be shared with the user committee even in case of a potential conflict of interests. Only where a conflict of interests is obvious (for instance, where sensitive information about participating competitors is disclosed) should the report or the respective information be subject to non-disclosure. Therefore, we are of the opinion that it would not be appropriate not to share the audit report or its findings with the user committee. We are, further, of the opinion that material issues in the audit report or serious findings (for instance, on book-keeping of the securities accounts) need to be disclosed to all users and not only to the user committee.

Q28: Do you agree with this minimum requirements approach? In case of disagreement, what kind of categories or what precise records listed in Annex III would you delete/add?

The described minimum requirements seem complex and, in our view, partly impossible to meet. It must be borne in mind that not all CSDs as of today – and even more newly established CSDs – will be able to provide all the information that is requested, particularly when it is to be provided for the past.

A new obligation to store information or records for a certain time (like 10 years) can be introduced from the date where the CSDR and the respective technical standards enter into force or from the start of the activities of a CSD (whichever is the later date). Compliance with such a requirement for the past 10 years, however, seems too extensive. EU CSDs should maintain their records inside the EU.

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?

1. Records

The RTS should require CSDs to build and maintain direct data feeds for their competent authorities. Such a measure might exceed the Level 1 text.

2. LEI

Para. 132 of the discussion paper considers the use of an LEI instead of the BIC. We are of the opinion that this will be problematic in many respects. Generally, the use of an LEI with regard to CSD participants only – as long as only banks are affected - could be possible. CSD participants who are banks should have obtained an LEI. However, as stated in para. 132 of the discussion paper, the cost of change from the BIC to an LEI will be significant.

The BIC is coded for a maximum of 11 digits. Within T2S, changing counterparty identification from a BIC 11 to BIC 8 context has been discussed. The cost for this change has been evaluated and proved to be very high. Accordingly, the change has been rejected. Since the evaluation was not carried out by our members, we are unable to deliver the cost estimate. We will, however, try to find out details and provide ESMA with them as far as possible.

It must be borne in mind that T2S and all current CSD systems are configured to the BIC and its use is mandatory. All messaging (SWIFT) used is based on the BIC, too, which was invented by SWIFT. This would also imply a significant change.
According to Article 29 CSDR, ESMA is to develop technical standards to specify the details of record keeping. We doubt, however, that it provides for a mandate to invent new standards. We would like to suggest including approved standards.

And last but not least, we would like to point out that the use of an LEI for the customers of CSD participants could involve huge costs and may constitute an offence against data protection law:

Although para. 132 does not yet consider the use of an LEI for clients, we would like to point out the cost involved if clients were to be identified by an LEI. At least for account holding systems that provide for individual client segregation, it cannot be excluded that the use of an LEI will be considered in the future. This may already be the case for the Nordic markets, which are built upon the direct holding model. In contrast to EMIR, where only the counterparties to a derivatives transaction will be obliged to have an LEI issued, any entity holding financial instruments would be forced to issue an LEI.

The issuance of an LEI costs € 150, followed by an annual fee of € 100, for instance, at WM Datenservice. The cost of a (pre-)LEI at other local operating units (LOUs) is similar. Lessons learned from EMIR have revealed some difficulties with the use of LEIs including the unwillingness of some customers to obtain an LEI. Taking into account that the counterparties involved in the derivatives business amount to several thousand, we would like to point out that under CSDR millions of customers would be affected.

When looking only at Germany, this would mean: approx. 180,000 accounts exist for non-financial legal entities. In total, 23,578,000 accounts exist at German banks5. For the non-financial legal entities, this would involve costs of € 27 million in the first year and another € 18 million each following year. In case the LEI will – one day- be issued to private investors and retail clients, the costs would be as much as € 3,537 million for the first year and € 2,358 million for each following year. This would also mean a substantial rise in the cost of maintaining securities accounts for customers (approx. € 100 annually).

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.

1. Risk analysis

Yes, we generally agree. CSD participants should meet the requirements for access.

However, the risk analysis seems unnecessarily detailed. Concerning the legal risks, a CSD will hardly be in a position to assess the risks listed and should be entitled to rely on licensing, supervision and regulatory compliance of its participants. However, CSD participants are regulated banks. Their obligations towards the CSD differ from the obligations towards CCPs and usually comprise the fees to be paid for services of the CSD. There also are no obligations towards other CSD clients.

2. Other areas of risk

In our opinion, political risk (war, civil war, revolution, annexation) and environmental risk (nuclear incidents, natural catastrophes) are generally worth considering. However, we believe that the focus of such risk analysis should rather be carried out in connection with access by issuers than with access by participants. (See Q47.)

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.

Irrespective of the time frame agreed, this time frame should foresee situations which would grant more time for enforcement agencies to address scenarios where an applicant is refused access because it has failed to satisfy the Client Due Diligence and KYC standards of the CSD.

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[5] Deutsche Bundesbank „Statistik über Wertpapierinvestments“ April 2014, p.68

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.

Our national CSD Clearstream already has – in its own interest and that of the market - consistent monitoring and reconciliation measures in place to ensure the integrity of the issue. We do not see the need for or any additional benefit from extra reconciliation.

Q33: Do you identify other reconciliation measures that a CSD should take to ensure the integrity of an issue (including as regards corporate actions) and that should be considered? If so, please specify which and add cost / benefit considerations.

The measures described are sufficient. However, on days of high volume – i.e. when corporate actions take place – more reconciliation batches should be executed than on regular business days. The details should be left to the discretion of the CSDs.

In the event that a discrepancy arises, the financial instrument should no longer be available for settlement at the level of the CSD until the discrepancy is resolved. This procedure will also be available under T2S.

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 that double entry accounting should be sufficient to offer a robust solution at a reasonable cost.

Q35: Is the above definition sufficient or should the standard contain a further specification of operational risk?

No comment.

Q36: The above proposed risk management framework for operational risk considers the existing CSDs tools and the latest regulatory views. What additional requirements or details do you propose a risk management system for operational risk to include and why? As always do include cost considerations.

Most important will be to ensure that technical standards on operational risk are in line with the detailed CPSS-IOSCO requirements on this topic. In order to ensure consistency with global standards, the PFMIs should therefore be the basis for all requirements.

Q37: In your opinion, does the above proposal give a sufficiently robust basis for risk identification and risk mitigation, or should the standard also specify other measures? Which and with what associated costs?

No comment.

Q38: What are your views on the possible requirements for IT systems described above and the potential costs involved for implementing such requirements?
We note that a mandatory (at least) yearly review of IT systems and the IT security framework (para. 167) clearly goes beyond current practice and is not necessary, also given the complexity of such an exercise.

Q39: What elements should be taken into account when considering the adequacy of resources, capabilities, functionalities and staffing arrangements of the secondary processing site and a geographic risk profile distinct from that of the primary site?
Technical standards should provide for the possibility for CSDs to set up their second processing site in a Member State different from their home member state. Such a possibility is of course only relevant in a very limited number of cases today, for instance for CSDs that are part of a group that includes other CSDs and similar markets, but could become more important with increasing integration of EU financial markets and should thus not be prevented by law.
With regard to the maximum recovery time of 2 hours, this should be the target for critical functions in general, with enhanced flexibility for non-critical functions.

Q40: In your opinion, will these requirements for CSDs be a good basis for identifying, monitoring and managing the risks that key participants, utility providers and other FMIs pose to the operations of the CSDs? Would you consider other requirements? Which and why?
No comment.

Q41: Do you agree with the approach outlined above? In particular, do you agree with the approach of not distinguishing between CSDs that do not provide banking services and CSDs that do so?

1. ESMA’s approach

We generally agree with ESMA´s approach. We also agree that CSDs should not invest in derivatives. However, if a CSD invests in a liquid financial instrument in a foreign currency, the CSD should be entitled to hedge the risk that derives from the currency. The hedging transaction should not be mistaken as an investment. We do agree that wherever an alternative to a derivative is possible in order to hedge a risk with the same effect and less risk, the CSD should be bound to take the alternative. Wherever no such alternative exists, a hedge by a derivative transaction must be possible.

2. CSD distinction

No, CSDs that provide banking services are already subject to a stringent regulatory framework. Consequently, the proposed RTS should only apply to CSDs which are not authorised to provide banking services.

Q42: Should ESMA consider other elements to define highly liquid financial instruments, 'prompt access' and concentration limits? If so, which, and why?
Central bank eligibility, in combination with the possibility to allow a wider range of instruments specifically for CSDs with a banking licence, should be considered for this purpose.

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.
Yes, the proposed measures are appropriate, including the adoption of additional requirements for interoperable links, as is already the case today.
We agree that links should be conditioned on the elements mentioned in the discussion paper. Additionally, CSDs should identify and assess sources of risk also in a

- political (war, civil war, revolution, annexation) and
- environmental (nuclear incidents, nature catastrophes)

respect, especially regarding a loss of financial instruments or access to them.

Q44: Do you find the procedures mentioned above adequate to monitor and manage the additional risk arising from the use of intermediaries?
No comment.

Q45: Do you agree with the elements of the reconciliation method mentioned above? What would the costs be in the particular case of interoperable CSDs?
No comment.

Q46: Do you agree that DvP settlement through CSD links is practical and feasible in each of the cases mentioned above? If not explain why and what cases you would envisage.
No comment.

Q47: Do you agree that the risk analysis performed by the CSD in order to justify a refusal to offer its services to an issuer should at least include legal, financial and operational risks? Do you see any other areas of risk that should be considered? If so, please give examples.
We agree that the risk analysis performed by the CSD should at least include legal, financial and operational risks. As mentioned in Q30, political and environmental risks and circumstances should also be considered.

Regarding the legal risk, it may be questionable if a product which is considered to be a security in one jurisdiction must be accepted by a CSD if its own jurisdiction does not deem this product to be a security. Furthermore, legal risks with regard to the lack of reliable information sources (e.g. no publicly accessible commercial register) or tax conditions linked to the securities should be taken into account as well as risks arising from compliance/anti money laundering/“know your customer”-principle.

Q48: Do you agree that the time frames as outlined in the procedure above are sufficient and justifiable? If not, which time frames would you prefer? Please provide reasons to support your answer.
While the proposed time frames are appropriate for most cases, flexibility should be foreseen as well. However, the regulatory authority should not force a CSD to breach its compliance standards by requiring it to admit a security.

Q49: Do you agree that the time frames as outlined in the procedure above are sufficient and justifiable? If not, which time frames would you prefer? Please provide reasons to support your answer.
Besides regulating the link acceptance or refusal procedures, the RTS should also establish a reasonable time frame in which the link should be implemented as link implementation timeframes have been access barriers in some markets in the past.

Q50: Do you believe that the procedure outlined above will work in respect of the many links that will have to be established with respect to TARGET2-Securities?
No comment.

Q51: Do you agree that the risk analysis performed by the receiving party in order to justify a refusal should include at least legal, financial and operational risks? Do you see any other areas of risk that should be considered? If so, please give examples?
Considerations with regard to compliance, “Anti Money Laundering” and the “Know Your Customer”-principle should be included.

Q52: Do you agree that the time frames as outlined in the procedure above are sufficient and justifiable? If not, which time frames would you prefer? Please provide reasons to support your answer.
No comment.

Q53: Do you agree with these views? If not, please explain and provide an alternative.
No comment.

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?
No comment.