European Banking Federation

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Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.

EBF RESPONSE TO ESMA DISCUSSION PAPER ON DRAFT TECHNICAL STANDARDS FOR THE REGULATION ON IMPROVING SECURITIES SETTLEMENT IN THE EUROPEAN UNION AND ON CENTRAL SECURITIES DEPOSITORIES (CSD)

General Comments

The European Banking Federation (EBF) welcomes the opportunity to comment on the ESMA Discussion Paper on Draft Technical Standards for the CSD Regulation (CSDR).

The EBF has focused its comments on the settlement discipline part of the Discussion Paper, and from an intermediary perspective. The Federation has also made some remarks on aspects having an impact on CSD participants, like the issues of record-keeping, access to participants and the integrity of the issue.

Because of the already quite detailed provisions on settlement discipline in the primary legislation (i.e. level 1 text), and considering the high settlement efficiency which characterises today's situation, the EBF believes that measures for a new and harmonised settlement discipline regime need to be practical, proportionate and time-appropriate in order to further enhance settlement efficiency. These measures should also be realistic in the sense that they should not add unnecessary obligations to existing developments (e.g. T2S, but also the various harmonisation initiatives within the industry).

Settlement efficiency has been monitored on a regular basis throughout the past years. According to an ECSDA statistical exercise *"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"*[1]. If we take these figures, the provisions on buy-in procedures in CSDR will affect less than 0.5% of all settlements. The EBF thus invites ESMA not to "crack a nut with a sledgehammer". Any implementing measures which do not build on established systems or substantial changes to them may have a reverse impact on the stated objectives of CSDR.

Certainly, the creation of a settlement discipline regime which can be applied to all models of trading, clearing and settlement will be extremely challenging. It is important to note that unlike T+2, which primarily and mainly targets securities transactions executed on trading venues, settlement discipline affects **all** securities settlements, regardless of how a security is traded and whether it is cleared or not.

There are a number of important issues to consider when designing a settlement discipline regime at European level. Across the trading life cycle, the different models of trading and settlement will

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

impose different obligations upon participants and intermediaries depending on the model and their position in the intermediary chain. A market infrastructure or an intermediary may have different liabilities depending on the trading and settlement model in question, and in many instances will have insufficient or incomplete information about the trade and their counterparties to accurately execute a buy-in procedure on the correct offending counterparty. All of these issues must be taken into account by ESMA when designing the CSDR settlement discipline regime, as all trading and settlement models must still be able to function correctly.

As a general principle, the EBF believes that buy-ins and all related characteristics need to happen at the level of **trading** counterparties and not at the level of settlement intermediaries (CSD participants, sub-custodians and custodians).

In order to facilitate this process, all necessary information to complete the buy-in must travel along the intermediary chain to the transgressing/transgressed parties. This may take time, especially if the information on the counterparties or the reason of the fail is incomplete or contested.

There are four types of trading and settlement models which occur today:

1. Trading on a trading venue but with no CCP-clearing prior to settlement;
2. Trading on a trading venue with CCP-clearing prior to settlement;
3. Trading OTC but with CCP-clearing prior to settlement; and
4. Trading OTC with no CCP-clearing prior to settlement.

According to Art. 7 para. 10 a), b) and c) CSDR, this will result in the following three buy-in procedures:

Trading on a trading venue but with no CCP-clearing prior to settlement (scenario 1 above):

In this instance, the trading venue has rules for the settlement of trades executed on its platform, but has a legal relationship with both trading members, and can set out in its rules a buy-in procedure.

Trading on a trading venue with CCP-clearing and trading OTC without a trading venue but with CCP-clearing (scenario 2 & 3 above):

In these instances, the buy-in regime is the responsibility of the CCP. It is important to note that in this model, the CCP will net the trades prior to their transmission to the CSD. Should securities not be delivered to the CCP and there is the risk of a settlement fail, the CCP can, after a certain grace period, execute a buy-in procedure with clearing members bearing liability. The clearing member then passes the cost of that buy-in procedure to its clients via their written contractual arrangements and in line with their rules as a clearing member. This procedure can also be classified as being top-down. Today, buy-in procedures already exist for CCP-cleared transactions (see e.g. Art. 15 of the Short-Selling Regulation).

Trading OTC without a trading venue and no CCP-clearing prior to settlement (scenario 4 above):

This model poses the most problems regarding the imposition of a settlement discipline regime for unlike the scenarios above, settlement without a trading venue or clearing house is 'bottom-up' i.e. it is dependent on counterparties to the buyer and seller meeting the provisions of the CSDR's settlement discipline regime. The reason it is bottom up is that as the CSD does not have vision of these counterparties – it sees only their respective custodians who are the actual participants to the CSD – it is not possible to pass through the intermediary chain the buy-in liability, especially if the ultimate client is outside the EU and not subject to the CSDR.

If any CSDR Delegated Regulation, or the rules of a CSD, were to impose any kind of buy-in obligation or risk on a CSD participant acting in the role of a CSD participant (and not acting as a trading party), this would be deeply problematic. Custodians hold assets – their role in the settlement process is to execute their clients' instructions (often via a broker) to deliver securities to the CSDs for settlement. They have no legal power to 'buy-in' a client should that client fail to deliver an asset or have it available for settlement. Should ESMA create a regime where the liability falls on custodians without the means to pass this directly through to their ultimate clients, this may:

a. Result in an increase in costs for clients as custodians factor in this new legal risk;
b. Result in some market participants denied access to custodian services should they be considered an unacceptable settlement risk (this may be especially true where client is based outside the EU and not considered itself bound by the CSDR); and
c. May see investors withdraw from EU custodians due to these higher costs and obligations of the CSDR.

Additional problems arise when the actual process behind a buy-in is considered. It is unclear what exactly constitutes the start of the buy-in process. Concretely, it is unclear who determines at what point in time who will be appointed to execute the buy-in. It is also unclear who can be appointed as a buy-in agent. Today, the ultimate clients are responsible for taking these decisions at their own risk and for giving the respective instructions. What is clear, however, is that it will have to allow for a notice to travel along the intermediary chain, as well as the possibility of a dispute. A potential time line could be:

1. Intended settlement date (ISD) + 4 is reached – settlement continues to fail;
2. A notice of fail and intention to buy in is sent to the buyer and the seller. At this point the parties will:
    a. Reject the buy-in notice, in which case there will be a indeterminate period of negotiation; or
    b. Accept the buy-in, in which case the buy-in process is executed (most likely via an anonymous auction).
3. The execution of the buy-in attempt 1 occurs; in the event of a fail there will be a second attempt.
4. The execution of the buy-in attempt 2 occurs; in the event of a fail there will be a third attempt (optional).
5. The execution of the buy-in attempt 3 occurs; in the event of a fail it is accepted that a buy-in cannot be executed (optional).
6. Cash compensation calculation and payment.

Because of all the complexity and difficulties mainly associated with the non-CCP scenarios (scenario 1 and 4 mentioned above), **the EBF sees the need for further in-depth discussions between all concerned stakeholders** (market infrastructures and their users) **about the details of possible future models and solutions for an harmonised buy-in regime.** These discussions should take place immediately after the consultation deadline of 22 May with a view to jointly and rapidly come to a reasonable, practical and operationally workable solution to implement through technical standards the buy-in obligations of the primary legislation (level 1 text) in non-CCP scenarios, i.e. in situations not involving a CCP, but not only. **The EBF invites ESMA to facilitate such discussions and will readily support them,** being conscious that this significant revision of the settlement chain processing requires the involvement of all participants.

The EBF also stresses the critical importance of ESMA providing definitional clarity to the CSDR's key legal concepts. In particular, ESMA shall:

- Provide a clear definition of *settlement transaction* and how this applies to the underlying trade. It is the position of the EBF that it should only be possible to buy in a security (or apply a penalty) where there is a trade behind the settlement, and where a settlement fail leads to an economical loss which justifies penalties and buy-in. We also believe that unmatched transactions at the level of the CSD should not be subject to the settlement discipline regime as the CSD could not determine its validity;
- Provide a clear definition of *liquid* and *illiquid* securities. This is critical if there is to be a uniform application of the CSDR and will form the foundation of the CSDR's settlement regime;
- Ensure definitional consistency in regards to the categorisation of whether a security is liquid or illiquid across CSDR and MIFID2/MIFIR.

As regards the **timing of Article 7 CSDR implementation,** and referring to the joint industry letter of 4 November 2013, the EBF would like to stress again **the need for an appropriate transition period,** particularly with regard to the T2S migration, and application of any new technical standards on buy-in only **after** the last T2S migration wave. Within firms, the adaptation to T2S has already started and its implementation will last several years. During this period, all resources and capacities, both at the level of participating CSDs and their participants, are allocated to the successful implementation of T2S, which remains a major and an unprecedented change in Europe's market structure. Consequently, there will not be sufficient resources left for a parallel implementation of a new buy-in regime.

Indeed, given the slipped timeline of CSDR finalization, it is likely that the adoption of the technical standards will only occur once the T2S migration has already started. In its response to the Discussion Paper, the T2S Advisory Group has highlighted that while T2S might be the best place to provide for a settlement discipline regime, any activity involving the platform would require a considerable amount of planning. At the same time, pushing this requirement on the CSDs would further stretch their resources which are currently to the different migration waves in T2S. In addition, the EBF would like to remind ESMA that a settlement discipline regime would also have to be catered for by CSD participants, who can only start their own planning and adaptation process, once the CSD/T2S changes to the processes are known.

The EBF finally takes note of the ECB COGESI Report on settlement arrangements in Commercial Bank Money (CoBM) and we invite ESMA to refer to this report when drafting the full technical standards. In particular, the EBF would like to draw ESMA's attention to the recommendations issued under Sections 4.1 and 4.2 which provide for best practices in particular around early matching (however please take into consideration that this was mainly related to intra-day settlement) and the way that instructions are forwarded through the custody chain. We also would like to refer to the recommendations for (I)CSDs and the CSD Links with respect to support a full settlement cycle turn-around within an average of 30 minutes.

European Banking Federation

Response to the Discussion Paper

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?

When defining these elements, the EBF calls on ESMA to take into account the many solutions which are currently in use by the industry to handle confirmation and allocation (e.g. FIX for ordered placement, ISO 15022 MT messages for settlement, etc.). Several service providers also support these processes (e.g. SWIFT, Omgeo, etc.). The EBF also notes that the shortening of the settlement cycle and the focus on timely settlement of transactions will force investment firms and their professional clients to use such efficient solutions. Thus, in principle, there is no need to prescribe any specific standard on confirmation and allocation.

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.

The EBF – and the securities industry in general – supports automated processing. The receipt and processing of ordinary settlement instructions, hold and release instructions and other settlement-related instructions is automated in T2S for instance. And as technology has progressed, the last decade has seen greater adoption of STP procedures to drive greater cost and operational efficiencies, better operational risk reduction and better outcomes for clients.

The use of manual intervention cannot and should not be completely excluded in all circumstances however. Manual processing can be necessary in instances of transactions/messaging corrections, processing of specific corporate actions or tax reclaims and primary market transactions – these should not be prohibited where their use is needed to ensure accurate and timely settlement and is in the best interest of the wider market. Also, in particular cases such as crisis management, manual intervention may be needed. We do not support the creation of an exceptions list as this does not retain the flexibility required by the market, however we would support an examples list

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

Automated STP processes throughout the securities value chain are in place in several markets and are supported by different standards (e.g. FIX, ISO). Highly automated STP securities settlement is today mainly based on the globally used ISO 15022 MT messages and T2S requires the use of ISO 20022 messaging standard. Here, it should be noted that in the T2S context a co-existence between both ISO standards has been agreed.

Therefore, the EBF does not believe that communication procedures and standards should be further defined through any CSDR Delegated Regulation. This is currently and successfully done at industry level where specialists are working on the definitions of communication procedures and standards, harmonised market practices and their effective use by the whole securities' industry.

CSDs could however be encouraged to promote STP and to use ISO standards whenever possible. Two areas where there is scope for work to define standards are settlement-related registration processing, and settlement-related tax processing. The EBF also reminds that CSDR only applies to CSDs and their participants and that the latter have no power under CSDR to ensure automation in the rest of the securities chain and to mandate the use of specific communication procedures and standards down the chain but CSD participants can only encourage their clients to use automated processing.

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?

In line with current industry practice and the fact that T2S will introduce a matching regime, the EBF believes that matching should be made compulsory prior to any settlement activity. The T2S matching standards should form the basis of this regime. We however invite ESMA to clarify that the process of matching can occur at places outside of a securities settlement systems (SSS). Hence, the following exceptions should apply:

a. When instructions have already been matched by a trading venue or a CCP and are received by the CSD via a trade feed - here the trading venue or the CCP is matching the instruction;
b. In case of corporate actions processing - here the CSD would send a matched instruction into the system;
c. When instructions have already been matched by a CSD participant in direct holding markets for settlement in a CSD or T2S, for instance via a layered model;
d. For FOP transfers among accounts managed by the same CSD participants (collateral movements, account allocations in direct holding markets) - here the CSD participant would instruct in an "already matched" status;
e. For FOP transfers among accounts in the same CSD (independent of CSD participants) in direct holding markets, and
f. For other exceptional transfers such as those resulting from a Court order - in these cases, the Court order would specify the respective accounts and provide for the matching, However, it should be clarified that by such order no unjustified breaks in the reconciliation is created.

While the EBF supports mandatory matching, it does not however believe and supports that this obligation leads to the creation of a list of compulsory standardized fields. This is especially important considering that markets not joining T2S from the start may likely have an intention to join at a later stage; as such, we believe that they should have the necessary flexibility to make their roadmap to T2S, hence we should avoid, for instance, that they have to update systems that will be disconnected once they join T2S.

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?

The EBF supports the ESMA proposals relating to CSD functionalities. The Federation believes that the introduction of hold/release mechanisms is critical in order to allow CSD participants to send instructions to the CSD for matching, even though the necessary resources for settlement are not yet available.

The EBF however does not agree with the proposals for disincentives (including fines), and we do not agree with the proposed trigger for disincentives as of end of day on ISD-2. We believe that such measures would make the settlement process more cumbersome and inefficient. We also do not see the value in for further disincentives given that European markets are moving to a T+2 settlement cycle and fines will be applied as outlined by CSDR with effect from the settlement failure. Also, a deadline of ISD-2 is inappropriate for non-European market participants and end investors.

We also would like to stress that different types of participants have different possibilities to provide early matching. For instance, broker-dealers can more easily match early than intermediaries as they are dependent on their clients to deliver instructions (or amendments to instructions). Furthermore, the procedure described in para. 23 of the Discussion Paper should not be mandatory for CCPs. At the level of the CCP, settlement instructions can be netted continuously with the effect that settlement fails can be avoided. Several procedures are in place, like the so called “actual settlement date netting” (ASDN) or “continuous net settlement” (CNS) as well as the “trade date netting” (TDN) system (like described in para. 23 of the Discussion Paper). For the benefit of a high settlement efficiency, the EBF strongly recommends that all these options should continue to be offered.

The EBF is also concerned by the cost aspect as it cannot be excluded that some CSDs will use this requirement to adapt their system as an opportunity to raise cost and generate new lines of revenues.

Finally, the EBF supports the response provided by the T2S Advisory Group to this topic, which, *inter alia*, describes that there is not necessarily a correlation between early matching and high settlement efficiency (one of the core objectives of the settlement discipline regime under CSDR). Also, the response shows that early matching (while very beneficial) does not guarantee a high degree of settlement, as other elements need to be clarified for a transaction to settle (i.e. available resources, non-hold-status).

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 that CSDs should offer at least 3 daily settlements/batches per day in the absence of continuous settlement.

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.

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

The EBF does not believe that any CSDR Delegated Regulation should prescribe any aspect of the technical design of a settlement system.

Moreover, the Federation does not support the ‘shaping’ of trades and settlement instructions by CSDs. This represents an excessive degree of discretion for the CSDs.

Partial settlement should be undertaken at the discretion of the settling parties only and should not be made mandatory. We would note that T2S provides optionality around partial settlement 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 support CESR-ESCB Recommendation 5 for SSS and agree with ESMA's view that the decision to offer such arrangement should be left to each CSD and its participants.

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.

While the EBF generally supports reporting for transparency and risk mitigation purposes, we invite ESMA to concentrate on information and reporting frequency which is strictly relevant and necessary for markets' supervision.

For instance, as regards the type of instruments, we believe that it is sufficient to differentiate between shares and bonds; reporting the ISIN code will not add any value to the information reported. Information about the type of account structure (omnibus *vs* segregated accounts) could also be an important factor to better understand the different nature of fails across various CSDs; this would be especially relevant for differences arising from fails triggered by CCPs.

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

European banks 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. The basis of the information provided to participants should be near real-time trade status information, near real-time settlement confirmation, a reason why the fails have occurred (possibly indicated by a pre-agreed codes) for failing trades, with recommended courses of action where possible from their providers.

Participants should be able to decide to subscribe or not 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?

The primary legislation (level 1 text) is clear and does not necessitate any implementing measure/technical standard: "*These reports […] shall be made public by CSDs in an aggregated and anonymised form on an annual basis".* As this information will not show whether it is the participant or their clients who is responsible for the fail – the CSD cannot know this - it should therefore be made clear that it does not bestow liability. Detailed information should be between the CSD and its participants and not for the public. Such information should however be published in a harmonised way, otherwise it will not help market participants and public authorities to effectively compare market performances.

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?

As a general principle, the EBF believes that **buy-in should always be used at last resort.** There are indeed many low-liquid instruments where buy-in simply cannot be performed due to the unavailability of a security because of liquidity constraints.

The EBF agrees that the extension period should be based on asset type and liquidity, with the key delineation being between bonds and equities. As a general principle, securities which are liquid – as evidenced by their listing on regulated markets, MTFs or OTFs - and which are part of the book-entry system of the CSD should not be considered for an extension period.

As stated above, the CSDR must allow for a distinction between highly liquid equities, with large turnover and market capitalisation, and smaller, less liquid equities. In regards to bonds, a similar differentiation is required in regards to the lower grade corporate bonds and high grade government and mortgage bonds or corporate debt. This is important as corporate bonds are often illiquid as held as long term investible interests, whereas in the case of government and mortgage bonds and high-grade corporate debt, liquidity is usually provided by market-makers. These market-makers may withdraw from providing these functions if they were to become subject to a buy-in regime under which they borne a disproportionate level of risk or were too often incorrectly attributed as the cause of settlement failure.

As stated in the General Comments' section of our response, definitional consistency regarding the categorization of whether a security is illiquid or liquid is crucial. Here, the EBF believes that there needs to be one single source for the definition of which ISINs are to be considered as "illiquid". In this respect, we support ESMA's approach to refer to the criteria for assessing liquidity under Art. 2, para. 1 (7a) MiFIR, although many questions will remain open.

ESMA must also consider additional wider questions, such as what happens were a liquid instrument becomes illiquid, or vice-versa? Which entity, and on what basis, would define and decide these matters in a market context, particularly during times of market stress? And how would a change in status be made known to the wider market disseminated in such a way that would affect pricing or trading behavior?

Finally, we urge ESMA to adopt a **period of phase-in** when implementing the buy-in regime considering the timing difficulties mentioned in the General Comments' section above with regards to the T2S implementation in large parts of Europe as of next year.

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

The EBF calls for a clear definition of who are considered to be the "concerned parties" (para. 54 of the Discussion Paper). We believe that there is a lot of confusion about this and this may have an impact on the correct identification of who is the failing/offending party.

The EBF is of the opinion that for OTC transactions, the buy-in can only be executed at the level of the trading parties, and not at the level of the settlement activity. In particular, we would like to refer to the details provided by AFME in this regards and covering issues that require further analysis before a buy-in notice could effectively be issued by the trading parties.

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 could be considered impossible under the following circumstances:

a. For illiquid instruments, or for instruments with very low liquidity; in such a circumstance, a mandatory buy-in could have a negative price impact on the market;

b. The security subject to the buy-in ceases to exist (maturity or lose), or has been the subject of a corporate action;

c. The security is the subject of a legally directed trading halt (e.g. asset freeze, international sanctions, etc.);

d. The product is not transferable, unique or especially structured for a specific transaction.

In addition, all new securities should be exempt automatically until three business days after their issuance date in the system of the CSD. The CSDR system also exempts transactions in those securities moving from residual status to eligible for settlement in the CSD system, to allow them to be rebooked. The exemption period for ex-residuals should be 15 working days from the start date of the new security eligible for settlement in a CSD system in line with common industry practice.

Generally speaking, the EBF does not favour a technical standard on the coordination of multiple buy-ins on the same financial instruments. In most cases, it is not possible to identify linked transactions and thereby exempt transactions from buy-ins in the event that a transaction occurs across different trading venues and different CCPs. The decision to exempt certain linked transactions should remain at the discretion of the entity performing the buy-in. We therefore believe that market infrastructures together with their participants should maintain such procedures in place when applicable.

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

The EBF deems a buy-in to be ineffective in the following circumstances:

a. For repo transactions where the execution date and ISD have the same dates (such instructions should be flagged as repo transactions);

b. For repo transactions, securities lending/borrowing transactions, sell/buy back transactions and margin lending transactions, especially where contractual obligations under a (standard master) agreement exist (which contain certain rules for settlement fails);

c. For free of payment (FoP) transactions, such as where the settlement does not represent an underlying contractual agreement between a buyer and a seller to sell securities against an agreed price. Examples of where this occurs is a portfolio transfer between accounts of the same client, reallocation of assets across accounts, or corporate actions.

Securities in a repo trade are the collateral part to secure the cash financing. Therefore, we believe that the opening leg of a repo contract should not lead to a buy-in. The transaction just does not take place. However, the closing leg of such contract bringing the securities back to the securities providing party would need a buy-in if the securities receiving party cannot deliver the securities back. The situation is similar for securities lending transactions where the opening leg would be enforceable in theory but does not take place in practice.

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

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

Yes, the EBF agrees, except for CCP-cleared transactions. Here specific rules exist which take into account the volatility of markets and try to avoid disadvantages for the buyer. Those rules should remain possible.

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

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

The EBF does not agree on the grounds that the suspension of a CSD participant could result in systemically damaging market disruption far in excess of the original problems it is seeking to redress. At a minimum, the suspension of a participant should always be used as a last resort measure and only after alternative measures have been considered and applied.

The process to suspend a CSD participant must be clear and unambiguous yet still flexible enough to account for the range of circumstances which must be considered. The underlying cause of the settlement failures must be first analyzed and the participant judged on the performance over a suitably long period of time. The participant must have received a number of clear warnings that contain quantitative targets for redress, and its own measures to reduce settlement failures must also be considered. Failure by a CCP to deliver a security should also be taken into consideration when making the determination, as they often cause participants to fail onward deliveries. If the decision is taken to suspend a participant, the participant must have access to an appeal procedure which would freeze the suspension until a decision is reached. Finally, the consequences of suspending a participant must also be taken into account as it may have a negative impact on liquidity as the participant is removed from the market.

In order to avoid such consequences, the decision to suspend a CSD participant should always be taken together with the national competent authority.

Finally, the EBF notes that there are also examples of markets that do not have formal sanctions, but instead have processes in place to discuss these kind of situations with market participants. This has worked well in Denmark for example.

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.

As regards CCP-transactions, the EBF believes that 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 already aware of the underlying offender.

Transactions done on a trading venue but not cleared through a CCP would usually be settled on a bilateral basis. It would have to be questioned whether CSDs are in a position to determine such transactions as typically the trading venue is not involved in the settlement of those transactions. If however a trading reference is contained in the instruction such information might enable the trading venue to identify the underlying trading participants and hence arrange for the buy-in.

The EBF would also like to add that the approach taken by ESMA regarding account segregation should under no circumstances lead to a mandatory direct account holding model. We understand – and believe - that an account in the name of a custodian bank should be sufficient.

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

The EBF accepts that the aggregated volume and value of internalised settlements, as well as some further information, should be reported to the competent authorities. We support any measures which could help identifying, monitoring and addressing the potential risks that may result from the practice of internalised settlement. The Federation however believes that any such measures should be practical and proportionate and should not go beyond what is strictly necessary to meet the objective of the primary legislation (level 1 text), i.e. the data to be collected should be reduced to the minimum to what is considered as useful and meaningful information for the purpose of the transparency objective in CSDR. In this respect, we believe 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 detrimental for the customers.

The EBF also accepts the principle of quarterly reporting of internalised settlement, but considers that 5 days after the end of the quarter is unreasonably short to allow aggregation and review before transmission. At the end of a quarter the data will already be on average 45 days old, so the EBF believes that a longer deadline after the end of the quarter is more reasonable and practical without increasing any risk.

In our view, the reporting however needs to be clarified as follows:

- The MiFID classification should be used as a reference when stating the types of financial instruments/products in the reporting of the aggregated volume and value of transactions settled outside a securities settlement system (SSS);
- The identification of the type of operations should exclusively relate to the standard transaction types (i.e. DF/RF/DVP/RVP). If instructions should be settled outside of an SSS, custodian banks not always know the true background of the transactions, hence they only see the settlement instruction in its standard form, i.e. according to the type of operations above mentioned. An identification per financial instrument as regards the type of operations - such as repos, securities lending, tri-party arrangements, etc. - is not possible nor feasible. For the same reasons that CSDs cannot provide details of the trade, the settlement internalisers will not be in a position to provide such details either.
- The volume and value of failed transfer orders, as well as the underlying causes, can only be reported on an aggregated basis. The details for the underlying causes will be limited to “lack of securities/cash” or “unmatched transaction” because of the missing details.

Considering that all transactions seem to be captured by the future technical standards on internalised settlement, even transactions which are clearly not in the focus of the reporting obligation like transactions with no significant importance in terms of volume or value, the EBF believes that a certain threshold, or exemptions, should apply. For instance, transactions with retail clients, which are released on a free of payment basis should benefit from such threshold or exemption, otherwise they may have to be reported irrespective of their purpose, size or significance. Another example are transactions by one and the same client who merely transfers securities from one of his accounts to another account within the same bank and with no systemic risk involved.

Therefore, the EBF invites ESMA to revise the information to be reported and to narrow it down to the objectively essential information. These are, in our view:

- Aggregated numbers as regards the volume and value **above a certain threshold;**
- Types of financial instruments **according to MiFID classification;**
- Types of operations **according to standard settlement instructions;**
- Aggregated volume and value of failed transfer orders;
- Underlying causes of failed transfer orders stating “lack of securities/cash” or “unmatched transaction” only;
- Static information describing settlement internalisation procedures.

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?

The EBF agrees that the audit report should be shared with the user committee wherever possible. The audit report should not be shared where, for instance, it contains sensitive information about individual CSD participants. A conflict of interest identified in the audit report should not automatically be considered a reason not to share the audit report. There may be other circumstances which exist where it would not be appropriate to share the audit report with the user committee.

From a users' perspective, it would be advisable if such audit report would not only be shared with the user committee but would be published by the CSD. This will be important for users in their own due diligence activity.

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?

Currently, BICs are generally used for identification of financial institutions by a CSDs. BICs already are standardised identifiers which are widely used by different actors and offer unique identification. BICs offer more flexibility over LEIs as different branches or functions may have different branch-codes, which are necessary for organising function with a bank. Therefore, the LEI cannot replace the use of BICs to achieve the objective of CSDR as they are stated in the primary legislation (level 1 text).

The EBF therefore believes that the potential use of LEIs for record-keeping requirements by CSDs goes far beyond the primary legislation which – according to our understanding – does not aim at collecting more data on securities markets. Lastly, including LEIs in addition to BICs in CSDs record-keeping would have a significant cost for the industry which cannot be justified by the objectives of CSDR.

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

The EBF agrees that potentially CSD participants should be subject to a thorough analysis of their ability to meet the access requirements. Nonetheless, we would like to highlight that CSDR provides CSD participants to be legal persons which are deemed professional market participants in any case. Assessing their respective regulatory oversight should provide for a level of comfort that the custody activity could be covered.

Having said that, the EBF believes that a number of the risks listed in the Discussion Paper may actually be difficult to measure objectively and, as a result, may be open to subjective consideration or application (i.e. *"to guarantee the confidentiality of commercially sensitive information provided through the system"* or *"to demonstrate that is has the necessary internal anti-money laundering, anti-terrorist financing and anti-tax evasion measures in place").* The risks listed under "Operational risks" might, in our eyes, constitute reasons to terminate or at least block a relationship temporarily as those issues might arise in the go-live testing and day-to-day operations, but not upon the application to access the CSD.

Additionally, ESMA may take into consideration political or economic risks stemming from the application of the new participant.

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

The EBF is of the opinion that the timeframes outlined for the response of the competent authorities seem unreasonably long as, in a worst case scenario, a potential participant would have to wait 10 months before an on-boarding can take place. The Federation reminds that CSD participants usually are regulated institutions which already have to comply with a significant amount of regulation. Hence, CSDs should be able to rely on the work conducted by the regulatory authorities in the respective jurisdictions. The on-boarding of a participant to a CSD should not be mixed with the on-boarding of a participant to a CCP, where significant liability risks could result from market transactions which participants engage in. While the default of a participant can have significant knock-on effects in the market, these are probably more drastic in a CCP environment, than with a CSD.

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

The integrity of the issue will be key when entrusting securities to a CSD. As a result, the EBF believes that regular reconciliation is of utmost importance. In particular, if a discrepancy in holding is detected, a security should no longer be available for settlement at the level of the CSD until this discrepancy is resolved. Not having this in place could significantly increase the discrepancy in times of high settlement volumes. It should be highlighted that within T2S the blocking of securities to prevent settlement is foreseen and welcomed by industry participants.

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