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ABBL response to the Guidelines on participant default rules and procedures under CSDR

The Luxembourg Bankers' Association ("ABBL") is the professional organisation representing the majority of banks and other financial intermediaries established in Luxembourg. Its purpose lies in defending and fostering the professional interests of its members. As such, it acts as the voice of the whole sector on various matters in both national and international organisations.

The ABBL counts amongst its members universal banks, covered bonds issuing banks, public banks, other professionals of the financial sector ("PSF"), financial service providers and ancillary service providers to the financial industry.

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Introduction

Generally speaking, we consider that the case of default presents 3 key characteristics to be taken care of:

- Firstly, whether the defaulting entity is of a systemic nature or not;
- Then, as we consider that most failures bear their own underlying reasons, the default is by nature a case-by-case situation,
- In the end, prior to the default there may be a suspicious period that may require scrutiny.

In our view there are two essentials elements regarding the default procedures: (a) there should be able to avoid contamination and (b) it should be allowed the possibility for the defaulting entity to recover through restructuring. Therefore, regarding restructuring we believe there should exist means that are able to ensure that not all doors are closed and that a potential exit to a default remains.

To conclude reactivity and proactivity to each specific scenario is probably more important than a strictly defined procedure.

At last, a question may be raised on what exactly is a default and at what time does it occurs. Is the default always triggered after a Court procedure? Or is the default based on technical insolvency measures? The impact and consequences of the qualification may lead to different scenarios, notably vis-à-vis the potential exits.

Answers to the questions

Q1: Do you consider other stakeholders should be involved in the definition of the default rules and procedures of a CSD? If so, which ones, and what should be the level of their involvement?

The proposal appears to be open enough to let each CSD defines in its market the most appropriate procedures or scope of stakeholders to be involved. We would draw the attention of ESMA to the fact that on some markets there are industry representative groups (trade associations, T2S NUG…) that may provide valuable contributions in terms of stakeholder representation on top of institutions or the involvement of other infrastructures or authorities may as well be incorporated as the case may be. We think that in the case of industry representatives, these groups may be adequately represented by one person (chairman/woman for example). For efficiency purposes, a too large group is not advisable.

Finally, we would like to raise the fact that a default of a T2S payment bank may also impact a CSD and its participants although such a payment bank does not have a securities account and is thus not a participant of the CSD. A default of a T2S payment bank may cause difficulties because a participant using such payment bank would be left with no funding in T2S, which would impact the participant's ability to settle purchase instructions. We think that CSD default rules and procedures should ideally take into account the potential default of a T2S payment bank and the consequences of this.

Q2: Do you think that such acknowledgement process is appropriate? In particular, do

you consider it necessary for the CSD to verify the information regarding the default with the designated authority under the SFD before the CSD can take any action, or should the CSD be able to start taking actions based on its reasonable assessment of the participant's situation and on the reliability of the source that informed the CSD in the first place?

Regarding the acknowledgment and communication, we think that the approach should be careful as not all participants may reside in the MS of the CSD; some might even be located in 3rd countries.

Participant default rules and procedures subject to existing EU rules on finality and insolvency (i.e: SFD), which apply to all FMIs. It important that the adoption of guidelines on CSD participant default rules and procedures by ESMA does not result in a situation where CSDs would have to apply different rules from other FMIs.

We support the proposal to include in the CSD general terms and conditions that a defaulting participant has to notify of its default. We are nevertheless not convinced by the paragraph 15 stating that it should be requested that: "participants notify their default as soon as possible". Indeed, we are doubtful one defaulting party has for unique and first thought to send a letter to a CSD; this is even less likely if the participant is not located in the same jurisdiction. Therefore there may be room for an evidenced based default procedure at the CSD, which may then be checked against a party, be it official (NCA or the participant).

We think that it may be wise not to wait until the default occurs. Indeed, once a default is triggered it is too late for remedial action. Thus we would suggest that, in the case of institutions subject to recovery or resolution rules, these institutions should notify the CSD of their major difficulties prior to be in default. This would allow the CSD to be able to prepare contingency plans in case that participant actually defaults.

We do not foresee the need for the CSD to verify the information, as it appears unlikely that a non-defaulting entity will pretend to be in default. We would as well support the concept that if there is no action from the defaulting entity a CSD may with reasonable information trigger itself the default procedure.

Unless the defaulting party is of systemic importance for the CSD and thus may put its survival in danger or dramatically contaminate others, we do not consider that the information to be prepared for the NCA are an absolute need. Indeed, the NCA itself should be informed, by other sources, that a licensed entity has fallen.

Q3: Do you consider that the actions listed are appropriate, or that other actions should be listed? Should certain actions be mandatory, depending for instance on the type or size of default, the characteristics of the participant or the CSD or any other criteria?

We consider the actions listed partially appropriate, and should have a guideline role (as opposed to mandatory), to allow pragmatic case-by-case approach. It may be wise to implement severe ties with a party that is in default in order not to contaminate other participants in the CSD operations, we think that on a case-by-case basis there may be a need to foresee a/some specific scenarios. Specific scenarios should be possible in order for the defaulting party to continue to be able to settle trades with the CSD, which might help recovery and avoid contamination. Additionally, it may be wise to consider if

suspending temporarily participants may not be an idea to pursue at least to allow for the time to assess the situation.

In fact we interpret the point (a) and (b) as preventing contemplating a default chain. We consider that there may be different reasons to default and in some cases the entity may need to continue to be able to use CSD services to try not fall in default but to recover. In the proposal there seems to be no way out or in between, which would add even more pressure to the defaulting entity and place it in the impossibility to perform some trades. Accordingly, and based on an analysis of each specific situation, we would propose that a defaulting party may be allowed to use CSD services provided they are fully backed by collateral and "supervised" by the CSD.

In addition, we are rather skeptical on the requirement to "specify the consequences of the actions" a CSD takes (paragraph 20). As already explained, each default situation is different and specifying in advance consequences is difficult. Also, consequences of a default are usually unknown before implementing the default procedure.

With regards to client business executed by the defaulting participant (custody business) there is a need to identify a pragmatic scenario so that the participant's clients are not left out without settlement solution in the short term. If done so, completely cutting the access may add risks to the system at participant's clients level. Furthermore if cut from the CSD, the defaulting participant would be prevented from earning additional income in order to pay potential claims and, even worse, it would significantly hurt the defaulting participant's client business which would no longer be able to deliver/receive traded securities and would thus be subject to buy-in and penalty procedures under the CSDR. We therefore believe it is of utmost importance that transactions resulting from a participant's client portfolio can continue to move to non-defaulting participants.

Finally from a pragmatic point of view and to avoid aggravating an already difficult situation, it may be advisable to disable the acquisition in T2S of new settlements instructions to be settled in the CSD account of the participant.

Q4: Do you think other items should be included in the internal plans?

We do not think of other specific items to be included. However, as the nature of a default is essentially a case-by-case situation, which needs a tailored solution, reactivity and quick responses are probably more required than a too rigid procedure. Also, as default is essentially a case-by-case situation we doubt an exhaustive list of actions to be undertaken could be drawn for example when a participant is a large client in a CSD in another MS.

Q5: Do you think that information on the implementation of the default rules and procedures should be transmitted to other stakeholders? If so, which other stakeholders?

We think the scope of communication and the concerned entities are generally appropriate. Nevertheless, we would like to highlight that these communication procedures are needed above all for systemically important participants that may by their default – probably well communicated by other means – trigger a systemic crisis on other platforms or entities. In that latter vein, we do not think that the specific information of trading venues served by the CSD is always required notably because

the impact of a default may not be as important as it would be for counterparties or a CCP for example. A CSD is, in our view, primarily an agent of an issuer, rather than its settlement clients, there may thus be an issue of responsibility if the communication fails. These CSDs may not be willing to bear this responsibility, and thus, we would understand that CSDs communicate with the list of entities under para 24 if the default is the default of an issuer, but we are not so convinced if it is coming from a participant.

Q6: Do you think that such testing and reviewing processes are appropriate?

Testing procedures and reactivity may be appropriate as well as reviewing the procedures on an ad hoc basis. We are however rather skeptical on the reliance and effectiveness of such tests.