Reply form for the Technical Standards under the CSD Regulation

18 December 2014

European Securities and Markets Authority

Date: 18 December 2014

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper - Technical Standards under the CSD Regulation, published on the ESMA website.

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, please follow the instructions described below:

i. use this form and send your responses in **Word format**;

ii. do not remove the tags of type <ESMA_QUESTION_TS_CSDR_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and

iii. if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

i. if they respond to the question stated;

ii. contain a clear rationale, including on any related costs and benefits; and

iii. describe any alternatives that ESMA should consider

Naming protocol:

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA_ TA_CSDR _NAMEOFCOMPANY_NAMEOFDOCUMENT.

E.g. if the respondent were ESMA, the name of the reply form would be ESMA_TS_CSDR_AIXX_REPLYFORM or ESMA_CE_TS_CSDR_AIXX_ANNEX1

Responses must reach us by **19 February 2015**.

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/Consultations’.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading ‘Disclaimer’.

General information about respondent

Are you representing an association?	AFTI (Association Française des Professionnels des Titres)
Activity:	Post trade services
Country/Region	FRANCE

Q1: Do you think the proposed timeframes for allocations and confirmations under Article 2 of the RTS on Settlement Discipline are adequate?

If not, what would be feasible timeframes in your opinion?

Please provide details and arguments in case you envisage any technical difficulties in complying with the proposed timeframes.

<ESMA_QUESTION_TS_CSDR_1>

Executive Summary

Since it doesn't seem possible to make general comments on the Consultation Paper (CP) in the ESMA's form to reply document, our general comments are provided below.

Association Française des Professionnels des Titres - AFTI -(French Association of Securities Professionals) is the leading Association in France and in the European Union representing the post-trade businesses. AFTI gathers more than 100 members all market players in the post-trade industry: custodians/depositaries, investment firms, market infrastructures, issuers.

AFTI's members are deeply in the settlement and clearing process and are therefore within the scope of CSD regulation. However given the activities of AFTI's members, we have chosen to reply to only two parts of the Consultation Paper: **settlement discipline and internalised settlement**. The answer was elaborated in close relationship with the "Association des Marchés Financiers" (AMAFI) and AFTI fully supports its responses to the Consultation Paper.

Below are the main messages of the AFTI association:

Funds NAV (non ETF) are excluded from the settlement discipline and buy-in regime.
All CSD (whatever its turnover is) has to follow the penalty system decided--->no exemption to allow a level playing field
-Strong push for widening all T2S features across Europe (hold and release, partialling, autocollateralisation...)
-We have still serious reservations on the penalty regime upon a gross model (per failed transaction)--->we listed several cases where such model could not work (CCPs exemption, opt-out...)
-Buy-in must not be executed by CSD (or by settlement participant) --->it should happen at trading level
-Timing of implementation of CSDR : 24 months after publication of level 2 measures by ESMA-->Q4 2017
-Internalized settlement reporting: not in the mandate of ESMA to go bo beond aggregated volume and value of all transactions---->reporting required is too detailed and too burdensome

Finally AFTI reminds that its answer is supported by its member representing a sizeable part of the European post-market industry with roughly 20% of the European market shares both in terms of Assets kept in custody (2^{nd} in the world) at the National CSD or daily turnover. When focusing on the activity in the national CSD (EOC France) the French market represents 5,630 billions € of assets under custody, 21 millions of settled instructions with 78,676 billions € of capital processed at the CSD and 52,512 financial instruments admitted by the CSD(2013 figures). Last but not least the French market settles 98,8% of its instructions on due date.

Preliminary Remark

As a preamble to our answer, our understanding of CSDR is that funds NAV subscriptions / redemptions are out of the scope of the penalty discipline and buy-in regime even if a platform enables the passing of orders through its systems and that their settlement is being undertaken through a settlement system.

That point is particularly relevant for exchanges that provide a technical platform to pass orders on fund shares which are traded at their NAV price and subsequently settled through CSDs.

It is our view that such platforms cannot be considered as trading venues since:
- there is no multilateral parties interaction in those platforms, all seller and buyers face the same and identical counterpart : the fund itself;
- the transaction can only be considered as being accepted by the fund once the fund manager has accepted those transactions;
- the transaction price is not set through an order book.

Indeed, one key element to the trading venues definition of MIF II lies in its multilateral feature should they be regulated markets, MTF or OTF. Since article 4 (19) of MIF II provides the definition of ‘multilateral system' as “any system or facility in which multiple third-party buying and selling trading interests in financial instruments are able to interact in the system”), we consider that the multilateral feature criteria is not fulfilled, since buy and sell orders do not interact together, but each of them interacts with the fund itself.

In addition, each trading platform under MIF II shall allow for the interaction of multiple buy and sell interests “in a way that results in a contract”. As mentioned earlier on, such fund platforms cannot be considered as trading venues since they do not result in a contract yet. It has first to be confirmed by the asset manager before it can be considered as a firm contract.

We consider that fund platforms as described above cannot be considered as trading venues, and since such fund shares are not cleared it should be exempt from the application of article 7(2) to (9) from CSDR, as detailed in answer 16 of the European Commission FAQ (http://ec.europa.eu/finance/financial-markets/docs/csdr/20141003-csdr-faq en.pdf).

“16. What is the scope of the settlement discipline measures referred to in Article 7(2) to (9) as regards the financial instruments covered?

Article 7(10) provides that the settlement discipline measures referred to in Article 7(2) to (9) apply to financial instruments referred to in Article 5(1) (i.e. transferable securities, money-market instruments, units in collective investment undertakings and emission allowances) that are:
a) admitted to trading on trading venues (OTC transactions); or
b) traded on a trading venues (non-OTC transactions); or
c) cleared by a CCP (OTC and non-OTC transactions regardless of whether the financial instruments are or not admitted to trading on trading venues).

Article 7(10) therefore excludes from the scope of application of Article 7(2) to (9), transactions in financial instruments that are not admitted to trading and not cleared by a CCP.”

It is also our view that the above exclusion of certain type of funds (the ones that can only be redeemed or subscribed) from the settlement discipline regime cannot be applied throughout the fund shares, since other funds types (like ETF for example) are negotiated through trading platforms.

It is important this differentiation is being made and clarified so that funds subject to a subscription/redemption only process are not been caught by a settlement regime which would not be fit to their nature (a buy-in on a non-exchange fund would prove to be impossible through the markets).

We believe the application of the settlement discipline measures on a given financial instrument should publicly be disclosed in order to avoid any misunderstanding or misinterpretation regarding the application (or not) of the settlement discipline measures by CSDs.

In parallel to the listing of ETFs which generate genuine secondary market trades between participants (and which eventually result in subscriptions/redemptions only for the balance position of market-makers specifically authorized to subscribe to the ETF units), exchanges have also developed some forms of listing for NAV trading only that mechanically translate into subscriptions/redemptions of fund units (UCITS and AIFMD). This meets requirements from European asset managers both for making use of exchanges' transparency and accessibility networks as well as enhancing via listing the eligibility of their fund units with certain investors. Whereas disciplining the secondary market part of ETFs does meet the objectives of CSDR of smooth and efficient market operation, there would be no rationale to apply identical principles to the pure NAV Trading facilities abovementioned: indeed, the management of defaults in fund subscription/redemption already follows some established practices / rules adapted to the organization of asset managers, that will not be impacted by CSDR and should consequently remain the prevalent standards to follow for such NAV Trading facilities

Through (on Exchange) NAV Trading / Subscriptions - Redemptions facilities, Investors only face a single counterpart being the Fund Manager. Hence, the fund manager, by nature and purpose, will always be able to create / redeem funds units and therefore they can never lead to a settlement fail. Any theoretical situation whereby settlement would not take place as expected would require the CCP (or the exchange / CSD in case instruments are not cleared) turning to the Fund Manager to get the number of fund units adjusted either upwards or downwards as there is no secondary market where a buy in / sell out can be organized)

On top of that, primary market transactions are also excluded from CSDR.
All our coming answers take into account these assumptions.

Answer to Q1
For the financial instruments (including ETF but excluding all the other funds), the French Market Place agrees with the timings proposed by this consultation paper as we believe that they are operationally possible.

However some of the information required in those confirmations appears not realistic and may prove to be counterproductive as a matter of trade processing efficiency.

We confirm it is of utmost importance that the economic details of the transactions are confirmed as soon as possible, but adding new fields to the confirmation/allocation process such as the type of transaction, which is not critical and has not yet been standardized, will lead to differences and be therefore counterproductive. As mentioned, such data is not required today and will need technical adjustments for every party to a transaction. On top of that, adding this new field will probably delay the sending of the confirmations and may jeopardize the deadline considered.

For all these reasons the French market does not support the proposal to include transaction type in the confirmation/allocation process, because it hammers efficiency.

In addition to this remark, we are convinced that a clear definition of confirmation/allocation should be made and agreed by all stakeholders to make the process more efficient.

The proposed RTS mentions that "*For orders where the investment firm has received the necessary settlement information in advance of the transaction, the investment firm and the professional client may agree in writing that confirmations and allocations as specified under subparagraphs 1-3 are not to be sent*" (draft RTS, Chapter II, Article 2). This provision is contradictory with our understanding of what the allocation process is. According to us, allocation encompasses the detail of the global order in terms of quantity and split per clients, whereas it does not include the settlement instructions details. In the same way the confirmation represents all specific information to the trade: price ISIN code, client information…

It is crucial that confirmations are sent ASAP to avoid any misunderstanding on transaction terms, and that allocation provides for the split of the transactions between accounts/clients, as requested by article 6§2 of CSDR: "*ensure the prompt communication of an allocation of securities to the transaction, confirmation of that allocation and confirmation of the acceptance or rejection of terms in good time before the intended settlement date*"

However, we believe that the addition of settlement data (i.e.: the account references to/from which securities or cash is to be transferred and the identity of the account holder) must not delay confirmation and allocation. Some counterparties do maintain their security/cash inventories in different accounts, and the addition of the settlement data may prove to extend the time necessary to confirm and allocate transactions.

For funds dealt on the Primary Market

We disagree with the recommendations proposed by the ESMA, which does not seem applicable to funds that are dealt at NAV. First, we would like to outline that the Fund (primary market) Industry does not rely on confirmations and allocations. Second, its practices rely on contract notes, which are to be sent as soon as all parameters are known, including NAV which may be computed daily, weekly, bi-monthly or monthly.

NAVs are sent by Fund Administrators to TAs once NAV calculation is processed which depends on the periodicity of the vehicles. Periodicities are determined in prospectus by Asset Managers depending on operational constraints such as underlying assets, currencies…).

As a consequence, The ESMA proposed recommendations on confirmations deadlines are not applicable to the Fund Primary market Industry, and such specificity needs to be taken into consideration.

As an example of potential arrangements of deadlines to cope with the NAV calculation process:

- Deadlines for vehicles with daily NAV (such as Monetary Market Funds in France): D+1, end of day, D being the date of the subscription/redemption
- Deadlines for vehicles with weekly NAV: D+ 4 max
- Deadlines for vehicles with bi-monthly NAV: D+ 10 day.

Moreover, should ESMA implement such recommendations for vehicles with daily NAV, it is to be underlined that the whole industry actors would be under time pressure from collection of orders until NAV issuance which could increase the rate of fails.

<ESMA_QUESTION_TS_CSDR_1>

Q2: Do you agree with the cases when matching would not be necessary, as specified under Article 3(2) of the draft RTS?

Should other cases be included? Please provide details and evidence for any proposed case.

<ESMA_QUESTION_TS_CSDR_2>
We also agree with this proposal to avoid matching for already matched and free of payment instructions for a transaction involving 2 accounts belonging to the same participant.

However we would like to highlight to ESMA that the already matched concept is a pure T2S concept and should be precisely defined in the same way for the non T2S markets.

<ESMA_QUESTION_TS_CSDR_2>

Q3: What are your views on the proposed approach under Article 3(11) of the draft RTS included in Chapter II of Annex I?

Do you think that the 0.5% settlement fails threshold (i.e. 99.5% settlement efficiency rate) is adequate? If not, what would be an adequate threshold? Please provide details and arguments.

Do you think that the 2,5 billion EUR/year in terms of the value of settlement fails for a securities settlement system operated by a CSD is adequate? If not, what would be an adequate threshold? Please provide details and arguments.

<ESMA_QUESTION_TS_CSDR_3>
We do not share ESMA's approach.

Our main concern lies with the principle of an exemption as suggested by ESMA. We do not see why exemptions for "small" CSDs would be authorized and would allow them not to offer the hold and release, partialling or recycling measures.

In the context of increasing cross border transactions, the removal of Giovannini barriers which requires levelling the playing field on the operational aspects of settlement and the objectives of CSDR to promote settlement efficiency, it is to be recalled that

- the hold and release function eases an early matching in the CSD and therefore contributes to a settlement on time (most of the instructions put on hold will have been released on ISD);
- partial settlement as well as recycling are essential to an efficient settlement;
- the penalty regime aims to penalize the real defaulters and that cannot be achieved if a participant is charged a penalty because the system operated by the CSD offer less functionalities than another;

Moreover we consider that there should be a level playing field across Europe in particular to avoid any kind of arbitrage for multi-listed securities.
<ESMA_QUESTION_TS_CSDR_3>

Q4: What are your views on the proposed draft RTS included in Chapter II of Annex I?

<ESMA_QUESTION_TS_CSDR_4>

On measures to be taken into account by investment firms

We share ESMA's will to ease the settlement through requirements at the earliest stage of the transaction (i.e. when concluded). Indeed, if parties of the transaction disagree on the terms of the latter, it is unlikely that settlement will occur on time.

Based on the above agreed objectives, we do not share nor understand ESMA's proposal to allow parties of a transaction to not send any confirmation / allocation where the settlement information is known in advance.

The following quote of the draft RTS on settlement discipline, Chapter II, article 2 needs to be amended: "*For orders where the investment firm has received the necessary settlement information in advance of the transaction, the investment firm and the professional client may agree in writing that confirmations and allocations as specified under subparagraphs 1-3 are not to be sent. (CP on RTS page 114)*"

Indeed, we strongly believe that giving in advance the settlement details can never be synonymous of agreeing the terms of each transaction. Confirmation/allocation will always be needed between parties to a transaction.

On manual intervention

Manual interventions by the CSDs should be restricted to the minimum possible: contingency for instance, i.e.: when a participant is not able to send/amend/cancel its settlement instructions. In such cases, the CSD manual intervention needs to be based on its participant instructions and be processed through GUI enabling a consistency check of settlement instructions. In addition, each CSD must validate this possibility with its local regulator. Therefore a clear procedure should be established between the CSD and its relevant regulator.
Moreover there should be a harmonization in Europe around this topic in order to avoid misinterpretation and have a level playing field between CSD.
It is to be underlined that manual interventions are in some cases needed for a smooth management of some activities (for instance when a STP solution does not exist and fax has to be used). Although the French CSD continuously works towards STP process, for the time being, thanks to manual interventions from the CSD, a timely settlement may also occur (e.g. connectivity issue of a participant…).

On confirmation/allocation criteria

- <u>As regards the mention of any beneficiary account names/numbers of the buyer/seller</u>

  The French Fund Securities association understands the ESMA recommendation regarding the enhancement of the level of KYC concerning final beneficiaries but it strongly disagree with the mention of any beneficiary account names/numbers of the buyer/seller.

  The French Fund Securities Association would like to highlight that its transaction settlement model relies on a dematerialized & bearer form CSD model. Such model is aimed at enhancing and automating the level of settlement rate by reducing the number of information to be provided. Adding the beneficiary account names/numbers of the buyer/seller information in contract notes in a dematerialized and bearer form CSD model would cause a major increase in settlement fail rate, In that respect, the French CSD model does not provide such information (Article 314 – 89 of Book II of the RGAMF). Such model relies on financial Intermediaries as well as distributors identification with a CSD shareholding identification system.

The French Fund Securities industry would like to promote:

- the use of its orders earmarking practices based on French harmonized best practices promoted by the whole French Fund industry (earmarking of distributors via BIC/BIC 1 code in a specific field)
- the use of the French CSD shareholding identification system ("TPI") which could provide Asset Managers with an posteriori reporting on final beneficiaries, thus answering to the ESMA concern, should this reporting be based on regulatory pricings.

Moreover, we would like to draw the attention of the ESMA that there are other items to take into consideration specifically for the Funds industry

- As regards the Trade Date

We would like to point out the fact that, to enable funds settlement across Europe, harmonization is needed on "Trade date"

On the French market:

- For Funds with unknown NAV, the Trade Date is defined as the date on which quantity and amount is known, which is ultimately the date of the "NAV". Hence the Trade Date is the NAV date, even when it falls on Saturdays and Sundays.

- For other funds, The Trade date can be:
  1) Either, the Date of instruction receipt by the TA (for example, the day before the cut off time)
  2) Or, the date when the cut off times applies.

We would like also to remind to ESMA the utmost importance of our answer in Q1 for the funds NAV and timing of matching, as this would have huge impacts on the whole settlement chain

- At least, we would like to point out the fact that, to enable funds settlement across Europe, harmonization on decimals of quantities is required.

On matching criteria

As stated in our answer to question 1, ESMA's requirement to introduce the type of transaction all along the transaction life cycle (from its negotiation to its settlement as well as for reporting and record keeping purpose) raises several remarks:

- Although such field is not a mandatory field today in France, it does not prevent from keeping a very high settlement ratio (1.2% of the number of transactions only are failing on ISD);
- Such field will require a standardization (through the use of ISO standards) and rules to populate the field would need to be clear and not leave room to any misinterpretation from the parties of the transaction;
- The addition of such a field implies IT adaptations at the CSD, its participants and the participants' clients level that requires coordination and IT efforts in an already constrained environment;
- The addition of such a field may have negative impacts on the matching efficiency.

On system functionalities

We propose to add to the measures identified as facilitating the settlement, the auto collateralization mechanism.

We also push for the wider adoption of the T2S features described below in the allegement period. This type of details allows us for a proper monitoring of our settlement fails.

Allegement delay periods
The allegement message is sent after a certain delay, following the first unsuccessful matching attempt. The delay depends on time of receipt of the instruction.

If the instruction was received…	The allegement delay period is…
Before 13:00 on the intended settlement date	1 hour
After 13:00 on the intended settlement date	The allegement message is sent in real time

The 13:00 timing is defined as a 5-hour delay period measured backward from the FOP cut-off time (18:00).

On tolerance level

We strongly advocate for a single and harmonized tolerance threshold in Europe in order to facilitate the settlement mainly for cross border transactions. With this in mind, the 25 Euros threshold is a fair proposal. A predetermined fixed amount that is equivalent to 25 EUR needs also to be determined for settlement in other currencies. Indeed there is no rationale to use a tolerance level indirectly expressed in Euros (and therefore may vary) for domestic instructions that will settle in the domestic CSD in the local currency.

<ESMA_QUESTION_TS_CSDR_4>

Q5: What are your views on the proposed draft RTS on the monitoring of settlement fails as included in Section 1 of Chapter III of Annex I?

<ESMA_QUESTION_TS_CSDR_5>
The monitoring for settlement fails should be facilitated by some details given by the CSD to its affiliates for a better tracking and follow-up.

However some of the information to be published by the CSDs are burdensome and we do not see their added value with respect with the original goal researched. (Report per asset classes for instance).

Although we understand the need for such database, we would like to suggest some improvement that will make this reporting more efficient and in the meantime not leading to unnecessary costs for all the actors.

The below suggestions are also proposed by several other associations:

a) Pending instructions (which can still settle on ISD);
b) Failed settlement instructions (which cannot settle anymore on ISD), including information on:
  i) Initiation of buy-in;
  ii) Extension period;
  iii) Deferral period;
  iv) Buy-in period;
  v) Outcome of buy-in process;
  vi) Payment of cash compensation or settlement of the buy-in transaction;
  vii) Penalties referred to in Article 7(2) of Regulation (EU) No 909/2014.
c) Fully settled settlement instructions;
d) Partially settled settlement instructions, including the settled part and the missing part of either securities or cash;
e) Cancelled settlement instructions, including information whether it is cancelled by the system or by the participant.
For each of the categories of settlement instructions above, the following information should be provided:
– Whether an instruction is matched or not matched;
– Whether an instruction can settle partially;
- Whether and instruction is on hold;
- Where relevant, what is the reason for instruction being pending or failing.
<ESMA_QUESTION_TS_CSDR_5>

Q6: What are your views on the proposed draft RTS related to the penalty mechanism? Do you agree that when CSDs use a common settlement infrastructure, the procedures for cash penalties should be jointly managed?

<ESMA_QUESTION_TS_CSDR_6>
We recall our previous answer to the ESMA discussion paper back in spring 2014 as well as the position paper sent to ESMA end November. We are still not convinced that such penalty regime is fair for intermediaries (brokers), often in the middle in a chain of settlement instructions on the same underlying security. We remain of the opinion that such system will create an inflation of penalties to be paid and received and an important reconciliation workload to properly address and bill the relevant defaulting party. Indeed with this regime the main part of the collected amount will be used to offset the effect of a penalty, which should not have been paid. The proposed collection and redistribution mechanism aims to pass to the beginning of the chain the indemnity received by the “end of chain” participant (the defaulting one). Such a mechanism would be cumbersome and can easily be equivalent to a net system, which we favor, and be more or less equivalent.

We understand ESMA’s preference is for a “gross model” (a calculation at the failing settlement instruction level) going with a full redistribution of penalties perceived in order to take into account the context of fail chains (a participant may be unable to deliver only because it didn't receive what it expected; so it will be charged and reciprocally indemnified) rather than a "net model" (a calculation on a net failing position) based on the assumption that taking into account settlement instructions is levelling the playing field between CSD operating on an omnibus basis and those who don't.

Therefore we would like to draw ESMA's attention on the fact that in some cases the proposed model would not work or not achieve its aim to penalize the real defaulting party.

Indeed, settlement chains are not a "one to one / same quantity" shape and imply a complex structure. The future regime will have to cope with other scenarios that include such complexity, for instance the on-hold facility, the opt-out, the delivery thresholds, the settlement timeframe. To illustrate our concerns we will use examples.

But before let us recall the reasons for an instruction to deliver to be a falling one at the end of the day:

- the participant has no stock at all;

- the participant has stock but :

  - it puts its delivery instruction on hold in order to avoid any unintended use of its clients' assets;
  - the quantity available is lower than the quantity of the instruction and the receiver has opted out;
  - the quantity available is lower than the minimum quantity for triggering a partial settlement (for some type of financial instruments, such threshold might be significant)
  - the reception of the financial instruments (the stock remaining on the account) was settled too close to the cut of time to allow the settlement of the delivery

Furthermore, we would like to emphasize the fact that an unintended use of clients' assets in custody with an intermediary during the settlement day will not be caught by the proposed penalty process.

- **Immunization of a participant in the settlement chain**

65. The advantage of a mechanism whereby the amount of the penalty collected would be redistributed to the participant that suffered from the settlement fail lies with the immunization reached in case of chains of settlement fails. Indeed, in case of multiple fails, those participants that are in the middle of the chain would have to pay a penalty but would also receive the amount of the penalty collected from the previous transaction. As a result of netting, the participant would not have a cash flow but would be incentivized to cure the fail as in such case it would receive the penalty amount but would not pay itself a penalty. This result is better achieved when the amount collected and received by a participant are of the same value. This is the approach proposed in the draft technical advice from ESMA to the EC related to the level of the cash penalty, which is part of a separate consultation paper. (CP on RTS page 23)

In order to be workable, such principle needs not only that the full amount is redistributed but also that none of the stock linked to the delivery remains on the account.

Example n°1

The threshold for triggering a partial settlement is 500
C to receive 200 shares from A who fails,
C to receive 400 shares from B who settles
C to deliver 600 shares to D which fails for 600 (and a partial delivery of 400 is not taken into account because 400 is less than the delivery threshold)

C will be penalized for 600 and indemnified for 200, leaving a penalty on 400, while it would have been able to settle for 400, which seems unfair since its fail amounts should be taken into account only for 200. Such an example shows easily that the collection and redistribution of penalties is not being proportional to the fail, **which is precisely the commission mandate objective on article 7.**

For avoiding any undue penalty one solution might be to allow partial settlement occurring at the "first financial instrument available on the account" keeping in mind that such principle would lead to huge volumes, numerous reconciliation issues or manual corrections to be performed by CSDs, and would be costly for everyone.T2S applies quantity threshold based on a minimum settlement quantity/settlement unit multiples.

Example n°2:

C to receive 400 shares from B: settled (just before the cut of time)
C to deliver 400 shares to D: failing for 400 (the settlement day is closed)
C will be penalized for 400 and indemnified for 0

To fix the case of settlement just before the cut of time, one idea would be to ask CSDs to run some last settlement batch.

*In a net model and **if the instruction is not "on hold",** the calculation would have been respectively:*

Net position = - 600 (to be delivered) + 200 (to be received) + 400 (received) = 0
And Net position = - 400 (to be delivered) + 0 (to be received) + 400 (received) = 0

One precision should be made on what D will receive. The redistribution is directly linked with the model of penalty. A penalty per instruction needs redistribution per instruction (to be fair and respect the immunization principle as much as it can do) where a penalty based on the position doesn't work with a unitary redistribution and mean an indirect one (as done by Monte Titoli today). In fact a net model allows to handle separately penalization and redistribution.

Of course the end participant (for participants in the middle of the chain it is different since they **deserve** to be flat at the end irrespective of the model) would not perceive exactly the penalty paid by the first defaulting participant in the chain. It will rather receive a part of the collected amounts. It may happen than the participant will receive less than in the case of a gross model.

However we believe as ESMA that this regime aims to penalize failing settlement and that it remains up to parties to claim for an additional compensation:

"*In order to determine the rate that should be applied for the penalties rate per asset type/liquidity, it is important to note that the penalty is not structured to compensate for the loss that a counterparty may suffer and that is part of the contractual arrangement between the counterparties. Therefore it is not designed to replicate exactly the loss incurred by the failed participant, or the gains achieved by the failing participant. The purpose of the penalties is to be sufficiently deterrent and to introduce the desired incentives to prevent and reduce settlement fails. It also is an add-on to any claim in compensation that the failed party may contractually have over the failing counterparty*." (point 37 of the TA)

Thus should the party find that the amount transmitted by its participant (amount the latter perceived from the CSD) is not enough in respect to the loss it has to bear then it will claim its counterparty for real compensation. Actually it may want to do that even with a gross settlement.

- **Opt-out**

28. In the proposed draft RTS, CSDs are required to offer the "partials" functionality to their participants. This measure aims at facilitating the settlement, even for a part, of the settlement instruction. Following that approach, when a receiving participant does not accept partials, the penalties applicable to the failing delivering participant should only apply to the missing financial instruments or the missing part of the cash. As the impossibility to partially deliver is due to the choice of the receiving participant, the delivering participant should not be penalized. (Point 28 of CP on TA)

If the principle as described in the consultation paper will resolve the opt-out issue raised by the participants, we would like to highlight the fact that it is more a mean to avoid undue penalty than a way to penalize bad behavior.

Furthermore we consider that the concept of "missing financial instruments" should be further clarified in order to avoid any miss interpretation. Our understanding is that ESMA is targeting all financial instruments the participant should receive but that he did not.
The below examples will be based on this assumption

<u>Example 1 (avoiding undue penalty)</u>

- A has to deliver 200 shares to C
- B has to deliver 800 shares to C
- C has to deliver 1000 shares to D
- D has decided to refuse partial settlement (opt out)

Settlement scenario:
- B delivers effectively 800 shares to C
- A did not deliver its 200 shares to C
- C cannot deliver 800 shares to D because of the opt out choice of D

In this scenario and according to our understanding the "missing financial instruments" ESMA is referring to are **the 200 shares A has not delivered to C**. Therefore:
- A is fined for 200 shares
- C is charged for 200 shares (the missing financial instruments) and indemnified for 200 (the CSD will redistribute the penalty paid by A). At the end C is flat.
- D is indemnified for 200 shares only due to its opt out choice.

Having in mind that the penalty to be paid by a participant is determined solely by taking into account its falling receptions, the mechanism will not catch real bad behaviors.

<u>Example 2 (not penalizing bad behavior)</u>

- A has to deliver 200 shares to C
- C has to deliver 1000 shares to D
- D has decided to refuse partial settlement (opt out)

Settlement scenario:

- A did not deliver its 200 shares to C
- C cannot deliver anything to D because of the opt out choice of D

In this scenario, the "missing financial instruments" is again **the 200 shares A has not delivered to C**.

Therefore if C has no stock at all **i.e. being clearly short of 800 securities, then C will not be charged although he should have been for 800.** Indeed:

- A is fined for 200 shares
- C is charged for 200 shares (the missing financial instruments) and indemnified for 200 (the CSD will redistribute the penalty paid by A). At the end C is flat.
- D is indemnified for 200 shares only due to its opt out choice.

In a net model, the calculation would have been:
- 1000 (to be delivered) + 200 (to be received) + 0 (received) = -800

- **CCPs exemption**

66. The CSDR provides that the penalty mechanism shall not apply to failing participants that are CCPs. The exemption does not apply to the failed instruction but to the entity that is a CCP. This is justified by the fact that the CCP participants might fail and these failed participants should equally be subject to the penalty regime. As a result, in order for the penalty to apply to the transaction and allow automation of the penalty mechanism, ESMA proposes that when a CCP is involved as a failing participant or as a failed participant, the penalty should not be collected from or paid by the CCP but the CSD should provide the calculation to the CCP that should collect and redistribute the penalty from/to its clearing members. This approach would maintain the immunization principle whereby in case of chain of transactions, the amount would be paid and collected. The deterrent effect would apply to cleared transactions without impact on the CCP. Finally, the CCP would not have to develop a specific system as it would rely on the calculation performed by the CSD. (CP on RTS; page 23)

There are several issues consequent to this principle.

- <u>The CCP is not always flat at the end of the day (i.e. no financial instrument on its account)</u>

For the reasons explained above (existence of a threshold for partial settlement, settlements occurring just before the cut of time) a CCP may be in position so that there will be no balance between penalties and indemnifications as calculated by the CSD leaving the CCP with a debit/a cost.

Linked to this point, it might be useful to keep in mind that the partialling process may not be done at the very end of the settlement day.

- <u>The CCP will have to make a link between the failing/non failing CSD's partici-</u>

pants and the failing/non failing clearing members

Indeed not all the clearing members are also CSD's participants. It is quite common for clearing members to have settlement agents in order to offer their clients several markets. However the relationship remains between the CCP and its clearing member (the cash account to be debited / credited by the CCP belongs to the clearing member). Moreover should the clearer uses a settlement agent then one question may be raised: what will be the ground for a clearer to pay penalty due to a lack of securities/cash from its settlement agent? This will need at least clear contractual agreements between the various parties involved in this process.

- Even with a flat position at the end of the day, since penalties are on an ad valorem basis, there will be some small cash differences (amounts will be rounded) remaining within the books of the CCP (indeed, financial movements can't go directly from a clearer to another one).

- The CSD is responsible to penalize late settlements

it means that it would have to put in place contractual arrangements between the CSD and the CCP to control the right application of the penalties.

- Case where a CSD is out of the scope of the CSDR

(20) …. As that CSD may not be subject to that regulation and would therefore not provide the calculation to the CCP, the CSD subject to this regulation involved in the settlement of the transaction where the CCP is the receiving participant should also provide to the CCP the calculation of the penalties that it would have redistributed. This calculation should allow the CCP to collect and redistribute the penalty from and to its clearing members.(CP draft RTS page 109)

ESMA foresees the case of cross border settlements where one of the CSD is not regulated by the CSDR. The EU CSD will indeed calculate all the penalties / indemnities but all the failing settlements will be between the CCP and the non EU CSD. How will the EU CSD get the name of the participants?

- CSDs will have to be able to recognize amongst their instructions senders the CCPs or….their settlement agent

Indeed CCPs also may prefer to use a single settlement agent that covers several CSDs rather then being part to each of them.

- **Netting of the financial flows**

(18) For practical reasons and in order to limit the number of cash transfers, the CSD should net the amount to be received by a participant with the amount due to be paid by that same partici-

pant. This practical approach should be combined with the provision of sufficient details on the calculation of the amounts to be received by the participants so that it could transfer the amount to its underlying clients. (CP on draft RTS page 109)

Where a CCP is involved this is not the case anymore. At least the participant who is also a clearing member will handle cash transfers reciprocally with the CSD and the CCP. Assuming there is a settlement agent in the loop, there will be also cash transfers between the clearing member and its settlement agent. This will be complex and costly.

We would like also to mitigate the ESMA's rationale regarding a penalty per instruction (point 17 of the CP on draft RTS page 108)

"*…and at the same time incentivize that participant or its underlying clients to take action in order to prevent or cure the fail as it would then be entitled to keep the benefit of the redistribution*."

Indeed borrowing financial instruments has a cost (the price of borrowing with sometimes a minimum fee, the collateral to be posted, the operational cost for the borrowing and the return …). Therefore the participant would not be able to keep the benefit of the whole redistribution; at the best it will keep a part of it.

We are strongly convinced that borrowing financial instruments in order to flow the settlement relates to good behaviors irrespective of the existence of a penalty per instruction.

Regarding reporting to be made, ESMA requires (Article 7.4) CSDs to provide "*at time the details of the calculation of the penalties*". Participants would like to be provided with the information on a daily basis. Indeed a defaulting client will be more incentivised to solve a failing instruction if such action may stop the ongoing penalties. At the time the instruction is still failing it is still about P&L at the level of the trading; at the end of the month it is no more the case. We believe that a distinction should be made between the timing for the information to be provided and the timing of the invoicing process.

Finally we welcome ESMA's proposal for a "jointly managed cash penalties" system where CSDs uses a common settlement infrastructure. Such requirement will allow participants of the CSDs to be ruled by the same regime and will allow a smooth management of cross-CSDs settlements. However, man should note this will not cover all the cases. Therefore ESMA's proposal should be detailed enough to not let room for any interpretation by a CSD. It also raises the question on how will the regime handle failing settlements involving more than one CSD. As the regime is based on a "gross model" rather than a "net model" which is handled locally it means that the penalty should be passed on all along the chain of unitary settlement instructions crossing CSDs to reach the "end participant".

<ESMA_QUESTION_TS_CSDR_6>

Q7: What are your views on the proposed draft RTS related to the buy-in process?

In particular, what are your views on applying partial settlement at the end of the extension period? Do you consider that the partialling of the settlement instruction would impact the rights and obligations of the participants?

What do you think about the proposed approach for limiting multiple buy-in and the timing for the participant to provide the information to the CSD?

<ESMA_QUESTION_TS_CSDR_7>
Role of a CSD

We still believe that CSDs should not manage buy-ins by themselves but should provide relevant information and details to the entity that it has designated to execute the buy-in and that bears the risk of execution.

As a global comment, we believe that it should be noticed that the CSD is hardly able to rebuild a chain of settlements since the settlement chain is complex and involves multiple settlement instructions in a relationship between n settlement instructions to m settlement instructions, which can also include transactions with CCP's or trading venues concurring totally or partly to a settlement fail. In a nutshell, defining the fail settlement chain is hardly feasible and obvious in a limited number of simple cases. Based on this, we believe that the CSD may be in a delicate situation when designating the failing party and be in a delicate position vis-à-vis potential claims from the bought-in party or even be sued because of the exercise of that decision

ESMA should also be aware that CSDs will more have to analyse a set of unsettled settlement instructions linked to a single participant rather than a set of "1-1 same quantity" failed settlement instructions involving several participants.

We believe that things should likely be as such in the real life:

C to receive 100 shares from A
C to receive 100 shares from B
C to deliver 75 shares to D
C to deliver 20 shares to E
C to deliver 105 shares to F
(all instructions failing)
with for example F to deliver 200 shares to C (also failing since F waits the 105 from C)

Moreover we would like to highlight that according to level 1 as well as to article 7 of the mandate given by the Commission to ESMA at no time it was written that CSDs should be so deeply involved in buy-ins.

Level 1 article 7

10. …
(c) for all transactions other than those referred to in points (a) and (b) of this subparagraph, CSDs ***shall include in their internal rules an obligation for their participants to be subject to the measures*** *referred to in paragraphs 3 to 8*
…

*Without prejudice to points (a), (b) and (c) of the first subparagraph, CSDs **may monitor the execution of buy-ins** referred to in those points with respect to multiple settlement instructions, on the same financial instruments and with the same date of expiry of the execution period, with the aim of minimising the number of buy-ins to be executed and thus the impact on the prices of the relevant financial instruments.*

15. ESMA shall, in close cooperation with the members of the ESCB, develop draft regulatory technical standards to specify:
…
(c) the details of operation of the appropriate buy-in process referred to in paragraphs 3 to 8, including appropriate time- frames to deliver the financial instrument following the buy-in process referred to in paragraph 3. Such time-frames shall be calibrated taking into account the asset type and liquidity of the financial instruments;

(d) the circumstances under which the extension period could be prolonged according to asset type and liquidity of the financial instruments, in accordance with the conditions referred to in point (a) of paragraph 4 taking into account the criteria for assessing liquidity under point (17) of Article 2(1) of Regulation (EU) No 600/2014;

(e) type of operations and their specific time-frames referred to in point (b) of paragraph 4 that renders buy-in ineffective;

(f) a methodology for the calculation of the cash compensation referred to in paragraph 7;
…
(h) the necessary settlement information referred to in the second subparagraph of paragraph 10.

According to the texts above, a CSD:
- **shall** include in its internal rules an obligation for participants to be subject to the buy-in
- **may** monitor the execution of buy-ins

And ESMA shall specify the necessary settlement information in case of "*transactions not cleared by a CCP but executed on a trading venue;"* which do not correspond to the case in article 7(10) (c) (transactions with neither a CCP nor a Treading Venue).

Therefore we don't clearly understand the rationale for the role attributed to CSD in the draft RTS where a CSD shall appoint a buy-in agent or even send a notice to both parties.

<u>Role of CSD's participants</u>

We first want to recall ESMA that there is definitively no contractual relationship between participants to a CSD (not even speaking about the case of cross CSDs settlements). Contractual relationships are at the trading level.

Being the one that could be bought-in due to the default of a client will introduce a new risk to a participant (the risk to not recover the cost from the client). ESMA may be aware that a way to avoid such situation could be for the participant to not instruct before having the assurance to be able to deliver. Of course the latter will be charged for a late input of its instruction but this could be easily passed on to the client and will be much less expensive than a buy-in.

Role of a CCP

We would like also to have ESMA's view on the co-existence of two buy-ins requirements: the one in the CSD Regulation and the one in the Short Selling Regulation. Should the latter be removed, would it mean that as soon a settlement with a CCP does not occur in a CSD under this regulation it will not be submitted to any European buy-in requirement?
Moreover it may be noted that currently those two regulations do not have the same understanding of what is a buy-in since one includes the cash compensation where the other considers it outside.

- **ESMA's proposal**

Regarding what is proposed we would have appreciated some practical description on the process. The process is like a black box; what we know is that at the end "securities shall be delivered and the related instruction shall be deemed executed".

The CSD, CCP, trading venue or the receiving participant shall appoint a buy-in agent or execute the buy-in by auction. The buy-in agent shall not have any conflict of interest in the execution of the buy-in. The CSD and the trading venue shall allow the participant to provide the identification of its failing client or underlying client for which the buy-in shall be executed. Securities shall be delivered to the receiving participant and the related settlement instruction shall be deemed executed. (article 11 of the draft RTS page 125).

- Does the settlement agent deliver directly the non-defaulting participant? And in this case how will the cash movements be done (the original amount from the buyer to the seller and the amount of the buy-in between the buy-in agent and the defaulter)?

- Does it deliver the defaulter and so be paid?

Whatever the set-up is all the actors will have to replicate such operations in their accounting (for cash and financial instruments).

AFTI aims for an harmonized buy-in framework defined by ESMA to level the playing field, particularly in the context of interaction between CSDs: the case of a settlement instruction failing between two participants of two different CSD's needs to be addressed.

In particular, what are your views on applying partial settlement at the end of the extension period?

On one hand, we agree with the fact that opt out should be removed at the end of the extension period, on the other hand this removal should occur 1 business day prior to the end of the extension period in order to allow smooth settlement.

Do you consider that the partialing of the settlement instruction would impact the rights and obligations of the participants?

Full buy-in and partial buy-in will both impact the participant rights and obligations considering that the participant will have to guaranty the settlement at the CSD level on behalf of the complete settlement chain and will also have to monitor the risk and manage margin calculation / claim.

We do think that a CSD participant should not be responsible for applying the buy-in (we also think it should not be the CSD).
The participant is usually an intermediary which is not the final beneficiary of the securities and the CSD does not necessarily know the underlying clients. The requirement of identification of indirect participant would be of benefit for the transparency of activity, performance, risk management and culpability in the event of fail but irrespective of who will be appointed/requested to do so, the application of a partial buy-in makes the process more complex than necessary (for all players involved, thus including the CSD participant). If a full buy-in cannot be executed, a "full" cash compensation should be executed. All or nothing.

What do you think about the proposed approach for limiting multiple buy-in and the timing for the participant to provide the information to the CSD?

If the effort made by ESMA to find a solution to cover the normal case of several unrelated settlements but failing for the same sole lack of financial instruments need to be underlined we are not convinced that the approach will work easily(see our general comments above).

At least it shows clearly the difficulty to handle buy-ins at the settlement level. Indeed, CSDs are logically unable to rebuild by their own the settlement chain from individual failing settlement and thus need to rely on their participants who will in their turn ask their clients. Should the process be managed between the parties to the transaction (rather than the parties to the settlement), no exchange of information would be need. Each party knows exactly to whom it bought and to whom it sold and moreover this party is the one engaged to deliver / pay on time.

Furthermore we will be interesting in having some precision on how this process will be handled if the buy-in applies to a CSD. Indeed, CSDs may be participants of another CSD (acting as an investor CSD as defined by ESMA). Like any participant an investor CSD might be penalized and might appear as the first participant in a settlement chain when the CSD try to find the real defaulter and then be the one to be bought in. But unlike other participants, the investor CSD is also required to apply a buy-in process within its books. Isn't there a risk for a buy-in to be applied twice?

Finally we would appreciate some explanation on the last part of the point 89 of the CP (page 28):

89. In order to mitigate the risk of multiple buy-in in case of chains of settlement fails, and in view of comments received from stakeholders supporting involvement of the trading parties, ESMA proposes that participants should provide to the CSD some information on the instructions linked to the failed instruction. For that purpose, the participant may have to receive information from its own client through the chain down to the trading parties. This information would allow the CSD to anticipate that the settlement of an instruction would result in the settlement of *some other instructions and therefore to initiate the buy-in for one failed instruction instead of several ones. This should happen within the framework set in the CSDR i.e. for instructions on the same financial instruments and with the same date of expiry of the execution period.* ***This approach could not be used for cleared transactions given the difficulty to directly link the trades submitted to clearing and the settlement instruction resulting from the clearing of those trades.***

We would like to recall ESMA that an on-exchange transaction may lead to several settlements, one of them involving a CCP. A participant may risk a CSD buy-in because of a non-delivery by a CCP.

<ESMA_QUESTION_TS_CSDR_7>

Q8: What are your views on the proposed draft RTS related to the buy-in timeframe and extension period?

<ESMA_QUESTION_TS_CSDR_8>
We highlight that the MiFID II/MIFIR definitions for liquidity are for pre- and post-trade transparency and deemed to be instrumental for determining the extension period for buy-ins.

- Liquidity is a security specific measure, which in turn is a dynamic. Applying a constant measure across asset classes is inappropriate.
- Given the potential adverse impact for the market, it should be argued that the maximum 7 days should be correct extension period for all fixed income securities.

Regarding the extension period, we would like ESMA to bring some clarification in the case a CCP is involved.

As stated by the level 1 of CSDR in Article 7(5):

> *Without prejudice to paragraph 7, the exemptions referred to in paragraph 4 shall not apply in relation to transactions for shares where those transactions are cleared by a CCP.*
>
> Thus the extension period for settlements on shares involving a CCP (transactions with a CCP as one of the party) is 4 business days and cannot be extended.

The RTS regarding the extension period states (article 13 page 128 of the CP) that:

> *1. The extension period for bonds and for shares, excluding those shares cleared by a CCP or those bonds and shares that are SME growth market instruments, shall:*
> *(a) not be prolonged where the bonds or shares are considered to have a liquid market in accordance with point (a) of Article 2(1)(17) or point (b) of Article 2(1)(17), respectively, of Regulation (EU) No 600/2014;*
> *(b) be prolonged where the bonds or shares are not considered to have a liquid market, in accordance with point (a) of Article 2(1)(17) or point (b) of Article 2(1)(17), respectively, of Regulation (EU) No 600/2014.*

Then is the extension period of 4 business days:

- for all transactions on shares where the latter is recognized by a CCP (i.e. will benefit from its guaranty) irrespective of the parties of the settlement ("shares cleared by a CCP")?
- for all transactions where a CCP is one of the parties of the settlement ("where those transactions are cleared")?

If the second interpretation is the good one, we would like to draw ESMA's attention on the fact that, should it be an illiquid share, there might be different extension periods, i.e. buy-ins not triggered at the same moment for the same initial transaction. Indeed a clearing member between a CCP and a custodian in the settlement chain will have to face a CCP buy-in 4 business days after ISD and in the same time a CSD buy-in 7 business days after ISD.

Assuming different periods for buy-ins is something that could be envisaged then we would suggest ESMA to apply different timing irrespective of the liquidity of the financial instrument. In other words, CCPs would be required to trigger their buy-in process with an extension period of 4 business days where CSDs for the same financial instrument will require the buy-in to be triggered by a buy-in agent 7 business days after ISD. Doing so will limit the number of buy-ins triggered at the CSD's level since the CCP's buy-in will allow several failing instructions to settle (or find a way to be closed through a bilaterally cancelation combined with an exchange of cash) accordingly. The only point is that a clearer can pass on the "result" of the CCP's buy-in to its counterparty (the latter should not be able to oppose the OTC extension period).
<ESMA_QUESTION_TS_CSDR_8>

Q9: What are your views on the proposed draft RTS related to the type of operations and their timeframe that render buy-in ineffective?

<ESMA_QUESTION_TS_CSDR_9>

We welcome the idea to take into account transactions for which a buy-in will be ineffective. Repo transactions with short maturity are an example but they are other ones such as tri-party collateral operations. Regarding repo we would like to highlight that not only short term repo should be considered but also open ended repo/loan. Indeed in these cases both parties have not agreed an end (return) date for the transaction, and often determine this later in the lifecycle of the trade. Until the open ended repo/loan is recalled, both parties are comfortable in extending the transaction, and do not see the need to enforce settlement.
As both parties can close the transaction at any time, which may be within the extension period, we believe such transactions should be exempted too. Therefore we ask ESMA to delete the last part of Article 14(3) : "*where no intended settlement date is set for the second transaction of the operation*".

If the buy-in is considered as ineffective and therefore not triggered, it should be clarified what will happen to the failing settlement: cash compensation, other measures…<ESMA_QUESTION_TS_CSDR_9>

Q10: What are your views on the proposed draft RTS related to the calculation of the cash compensation?

<ESMA_QUESTION_TS_CSDR_10>
We have a concern regarding the respective roles of the actors involved in this process.

Indeed ESMA suggests that participants pre-agreed the price to settle the cash compensation but how can a settlement participant pre-agree an equivalent value in cash of an expected stock? This is clearly up to the party of the transaction to decide the amount needed to cover the damage undergone; in no case the participants of a settlement can agree such price. They are solely representatives at the settlement level of counterparties to a transaction and again they have no contractual relationship. They are only participants to a CSD.

Actually we are not convinced that such pre-agreement may work even if defined by the parties of the transaction.

Example:

A to sell to B with a pre-agreed price x
B to sell to C
C to sell to …
… to sell to M
M to sell to N with a pre-agreed price y

We have several independent transactions. The delivery linked to the first transaction (between A and B) failed and lead to as so many failing settlements as transactions. By handling information given by the participants the CSD found that a buy-in should be triggered against the representative of A which will solve all the failing settlements. Unfortunately the buy-in didn't succeed and the cash compensation process will apply.
The amount of the compensation will derive from the pre-agreement between A and B and will be passed on all along the chain until N. However N is the one who will really get cash instead of financial instruments, and therefore should set the price rather than receiving something agreed between two parties it just doesn't know.

To be workable the price should be the same all along the chain (i.e. the proposal (b) or (c) of article 15).<ESMA_QUESTION_TS_CSDR_10>

Q11: What are your views on the proposed draft RTS related to the conditions for a participant to consistently and systematically fail?

<ESMA_QUESTION_TS_CSDR_11>
The threshold of 10% proposed by ESMA is realistic as well as the comparison with the market efficiency.

However we still believe that the threshold should also consider the type of participant: for instance a market maker deeming to animate the market and be very active on the settlement system should not be perceived in the same way than a buy side actor.

Finally we believe that there should be in the case of suspension when stating that a participant consistently and systemically fail an appeal possibility.

<ESMA_QUESTION_TS_CSDR_11>

Q12: What are your views on the proposed draft RTS related to the settlement information for CCPs and trading venues?

<ESMA_QUESTION_TS_CSDR_12>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_12>

Q13: What are your views on the proposed draft RTS related to anti-avoidance rules for cash penalties and buy-in?

<ESMA_QUESTION_TS_CSDR_13>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_13>

Q14: Do you agree that 18 months would be an appropriate timeframe for the implementation of the settlement discipline regime under CSDR? If not, what would be an appropriate timeframe in your opinion? Please provide concrete data and evidence justifying a phase-in for the settlement discipline measures and supporting your proposals.

<ESMA_QUESTION_TS_CSDR_14>
We welcome the ESMA proposal to delay the entry in force of the RTS on settlement regime. As ESMA knows, the French market as well as 20 other European markets is in the process to migrate all its settlement in a common platform.

T2S is one the major and complex initiative European actors have to face with. This project which started almost 9 years ago is about to go live. CSDs and their participants will enter in the migration phases after a deep testing phase. They should focus their attention, resources on the migration. As for any project a black window should start where the only changes allowed should be to fix potential bugs. Moreover there should be a period after the migrations where no change should be made. This is of the upmost importance to state that T2S runs well.

Thus if it is clear that the RTS could not enter into force 20 days after its publication, AFTI is of the view that a 18 months period is still not sufficient.

CSDR is a project per se which would require adequate project management, resources…Thus, the banking industry needs a delay after the CSDR publication to cope with the new requirements: new reporting, new buy in regime, new penalties system. The aim of the future regime is not to simply penalize but to make settlement more efficient. This will go through an education of participants and through them of the real defaulters. Participants will not only do some IT developments in order to pass on the fines, the buy-in costs they will also have to explain, help their clients to change their behavior to cope with the new requirements.

Therefore we consider that after the last T2S migration (February 2017), 6 additional months for implementing the CSDR would be required. As a matter of fact, we consider that CSDR could not come into force before at the earliest Q4 2017 if everything goes well.

Finally we want to recall the suggestion made by several associations in a joint letter (November 2013) in favor of:

“The introduction of a transition period, during which settlement fails will be monitored by infrastructures and regulators (perhaps including a special monitoring and reporting regime by ESMA), prior to the full implementation of the new discipline regime. This fixed transition period will serve to monitor the expected effects and benefits from harmonization of the settlement cycles within the EU. Once harmonization on T+2 has taken place and TARGET2-Securities is implemented in the participating markets, the effects on settlement efficiency can be reconsidered and provisions for a harmonized settlement discipline can be implemented – if warranted. A transition period could also give market participants at all levels the opportunity to anticipate and correct potential problems in relation to the numerous changes being implemented simultaneously. It will also ensure that infrastructures and their users have had sufficient time to develop robust systems to deal with the new regime and to minimize fails".<ESMA_QUESTION_TS_CSDR_14>

Q15: What are your views on the proposed draft RTS on CSD authorisation (Chapter II of Annex II) and draft ITS on CSD authorisation (Chapter I of Annex VI)?

<ESMA_QUESTION_TS_CSDR_15>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_15>

Q16: What are your views on the proposed draft RTS on CSD review and evaluation (Chapter III of Annex II) and draft ITS (Chapter II of Annex VI)?

<ESMA_QUESTION_TS_CSDR_16>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_16>

Q17: What are your views on the proposed draft ITS on cooperation arrangements as included in Chapter III of Annex VI?

<ESMA_QUESTION_TS_CSDR_17>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_17>

Q18: What are your views on the proposed draft RTS on CSD recognition (Chapter IV of Annex II)?

<ESMA_QUESTION_TS_CSDR_18>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_18>

Q19: What are your views on the proposed approach regarding the determination of the most relevant currencies?

<ESMA_QUESTION_TS_CSDR_19>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_19>

Q20: What are your views on the proposed draft RTS on banking type of ancillary services (Chapter VI of Annex II) and draft ITS on banking type of ancillary services (Chapter IV of Annex VI)?

<ESMA_QUESTION_TS_CSDR_20>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_20>

Q21: What are your views on the proposed draft RTS on CSD participations (Chapter II of Annex III)?

<ESMA_QUESTION_TS_CSDR_21>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_21>

Q22: What are your views on the proposed draft RTS on CSD risk monitoring tools (Chapter III of Annex III)?

<ESMA_QUESTION_TS_CSDR_22>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_22>

Q23: What are your views on the proposed draft RTS on CSD record keeping (Chapter IV of Annex III) and draft ITS on CSD record keeping (Annex VII)?

<ESMA_QUESTION_TS_CSDR_23>
General comments

We welcome the ESMA's initiative to define the "issuer CSD".

Recordkeeping on flows

As a general comment we would like to highlight that since CSDs handle settlement instructions it is more about settlement instruction records here than transaction records. Indeed, even though, the type of transaction is populated (see our comments on this specific topic in questions 4), such record will give no real information on the transaction itself since the items are settlement details.

Regarding the list of items required:

Settlement instruction type
are "delivery with payment" (DWP) treated as DVP?

Transaction type and status type:
We believe that ISO standards should be used

Status type:
The values proposed by ESMA are not exclusive one from the others; for example, a settlement instruction may be matched and hold. Should the values remain as such, clear rules will be needed (which information is priority?)

Opt-out
How is the opt-out flag translated?

To conclude, we underline that all these requirement if agreed would then need to be endorsed by the ISO community and then developed by the CSDs and their participants.
The full process could last between 1 to 2 years depending upon the complexity of the changes and adaptations required.
<ESMA_QUESTION_TS_CSDR_23>

Q24: What are your views on the types of records to be retained by CSDs in relation to ancillary services as included in the Annex to the draft RTS on CSD Requirements (Annex III)? Please provide examples regarding the formats of the records to be retained by CSDs in relation to ancillary services.

<ESMA_QUESTION_TS_CSDR_25>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_25>

Q25: What are your views on the proposed draft RTS on reconciliation measures included in Chapter V of Annex III?

<ESMA_QUESTION_TS_CSDR_25>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_25>

Q26: Do you believe that the proposed reconciliation measures where other entities are involved in the reconciliation process for a certain securities issue within the meaning of Article 37(2) of CSDR are adequate? Please explain if you think that any of the proposed measures would not be applicable in the case of a specific entity. Please provide examples of any additional measures that would be relevant in the case of specific entities.

<ESMA_QUESTION_TS_CSDR_26>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_26>

Q27: What are your views on the proposed reconciliation measures for corporate actions under Article 15 of the draft RTS included in Chapter V of Annex III?

<ESMA_QUESTION_TS_CSDR_27>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_27>

Q28: What are your views on the proposed draft RTS on CSD operational risks included in Chapter VI of Annex III?

<ESMA_QUESTION_TS_CSDR_28>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_28>

Q29: What are your views on the proposed draft RTS on CSD investment policy (Chapter VII of Annex III)?

<ESMA_QUESTION_TS_CSDR_29>
Not relevant for AFTI <ESMA_QUESTION_TS_CSDR_29>

Q30: What are your views on the proposed draft RTS on access (Chapters I-III of Annex IV) and draft ITS on access (Annex VIII)?

<ESMA_QUESTION_TS_CSDR_30>
The French market Place disagreed with the definition proposed for an investor CSD, although we share the definition of the issuer CSD proposed (which makes a link with one of the core functions)

Indeed, According to ESMA (in the Annex IV) an Investor CSD means "*a CSD which has a link with an issuer CSD either directly or via an intermediary allowing its participants to hold securities in its securities settlement system which were issued through the issuer CSD*". Such definition cannot characterize a CSD. Indeed it is a pure commercial description of what any participant (should it be recognized as a CSD or not) of a CSD A may offer to its clients where the latter want to hold securities issued in CSD B. For any financial instrument the CSD is not the issuer CSD of, it acts actually as a normal global custodian.
<ESMA_QUESTION_TS_CSDR_30>

Q31: What are your views on the proposed draft RTS on CSD links as included in Chapter IV of Annex IV?

<ESMA_QUESTION_TS_CSDR_31>
Not relevant for AFTI
<ESMA_QUESTION_TS_CSDR_31>

Q32: What are your views on the proposed draft RTS on internalised settlement (Annex V) and draft ITS on internalised settlement (Annex IX)?

<ESMA_QUESTION_TS_CSDR_32>
General comments

Regarding the reporting itself, AFTI is of the opinion that it is too burdensome (.Some information required are not known today and should therefore be asked to the trading party: eg clients typology, assets classes) Beyond that we have several concerns due to ESMA's proposal.

Scope and level of granularity of the suggested requirements

Risk of misinterpreting

Article 9 states that "*Settlement internalisers shall report to the competent authorities of their place of establishment on a quarterly basis* ***the aggregated volume and value of all securities transactions*** *that they settle outside securities settlement systems*."

And the mandate says "*ESMA may, in close cooperation with the members of the ESCB, develop draft regulatory technical standards further specifying the content of such reporting*."

In no case it has been foreseen to require aggregated information split under different criteria.

Moreover such new requirement may introduce some confusion. Indeed what is expected by the Commission is a reporting of **securities transactions** that are internally settled. Even if we can regret once again this mix between trading and settlement levels this will have no impact until reports are global.

Having the information split then things will be different. What would it mean and how would it be used if a participant declares that it settled mostly for credit institutions? Would it be understood as "most of the transactions are concluded by credit institutions"?

A settlement done internally doesn't mean that the transaction has been concluded internally too. Clients of a participant are not always final ones. It is likely that they have clients behind them and therefore instruct their custodian for an aggregated or even for a netted quantity.

Therefore we disagree for any split of aggregated data

Type of client

Should the type of client be maintained then we ask ESMA to use the MIFID classification (retail, professional, eligible counterparty) rather than a too detailed one that will unlikely be useful and accurately populated (the client known by the participant is not always the final one and moreover may represent several types of underlying clients involved in the transactions).

Scope of financial instruments

We understand that the requirement is only for financial instruments admitted by a CSD regulated under the CSDR. Indeed information related to non EU ones will not be comparable to CSDs' figures.

To avoid any misinterpretation, we would appreciate that ESMA clarifies the point in its draft RTS.

Practical issues

We would appreciate some clarification on the requirements:

- does "failed transfer orders" means "failed matched transfer orders" (the definition doesn't mention it)?
- is it clear for ESMA that the settlement internaliser will report both legs? (a delivery for 10 by A and a receipt for 10 by B settle together will appear in the reporting as a settled quantity of 20)
- the volume of failed transfer orders is in the sub-column of "number of transfer orders" does it mean that only transfer orders that finally settle are to be reported?

<u>'Settlement fails' in the context of internalised settlement</u>

Once again, we would like to highlight that neither the article 9 of level 2 nor the mandate given to ESMA require information beyond the "***aggregated volume and value of all securities transactions*** *that they settle outside securities settlement systems*".

So we ask ESMA to limit its requirements to an aggregated volume and value of all settlement instructions that settle outside a securities settlement system.

Regarding fails, ESMA considers that:
"*338. … it is important to cover the investor protection aspect. ESMA is aware of the fact that 'settlement fails' in the sense of the CSDR definition cannot be used in the context of internalised settlement, however ESMA believes that the technical standards may focus on whether the transfers made in the books of the settlement internalisers occur when intended (according to the settlement internalisers' clients instructions, and evidenced by settlement or payment confirmations, end-of-day statement of transactions). ESMA has included a template for the reporting of failed transfer orders by settlement internalisers, which is a simplified version of the template proposed in the RTS on the reporting of settlement fails by CSDs*" (page 95 of the CP on RTS)

If the protection of the investor is crucial and if we understand ESMA's intention we are not convinced that such reporting on settlement instructions that failed to settle internally on ISD will cover this objective. As for external settlements, a failing instruction may be synonym of investor protection since it shows that no unintended use of financial instruments has been made by the participant.

<ESMA_QUESTION_TS_CSDR_32>