

22<sup>nd</sup> May 2014

**EACH response – ESMA discussion paper ‘Draft Technical Standards on the Regulation on improving securities settlement in the European Union and on central securities depositories (CSD)’ – ESMA/2014/299**

---

**1. Introduction**

The European Association of CCP Clearing Houses (EACH) represents the interests of 20 central counterparties (CCPs) in Europe. EACH supports the objective of the CSD Regulation to harmonise the timing and discipline of securities settlement across the EU. EACH welcomes the opportunity to provide input in the development of the technical standards relevant to CCPs to ensure any issues around the implementation of the requirements in the level 1 text are properly addressed.

Below you will find the responses to the questions of the discussion paper that we believe are relevant and have an impact on CCPs. As requested, we have indicated the number of the question to which our responses refer to and propose alternatives for ESMA to consider when needed.

Please note in particular that:

- EACH supports the flexible approach under of the CSD Regulation around the different buy-in procedures for financial instruments, depending on the asset type and the liquidity. We believe ESMA should calibrate a buy-in process and timeframes for illiquid cleared shares that mitigate the incentives set in the level 1 text for market participants to move away from central clearing.
- EACH suggests allowing for the execution of the cash settlement to be done by the CCP for cleared business. In addition, CCPs should be able to set the settlement price at their discretion for the purpose of the cash compensation because the single failed settlement instruction may be the net of many trades from many trade sources.
- In respect to the implementation, EACH believes that ESMA RTS on mandatory buy-ins should only apply after the last wave of T2S (i.e. by 2017). This transitional period takes into account the effort that CSDs are making to implement the T2S project and the move to T+2 settlement cycle, which has a significant impact on market participants and other infrastructures. Also after the implementation of the T2S project, there will be more certainty around the fact that the buy-in regime penalises the intentional fails, rather than those occurring due to issues with settlement infrastructures.

## 2. Response to specific questions

### Section III.I – Settlement Discipline

#### Matching of settlement instructions

**Q4: Do you share ESMA's view that matching should be compulsory and fields standardised as proposed? If not, please justify your answer and indicate any envisaged exception to this rule. Are there any additional fields that you would suggest ESMA to consider? How should clients' codes be considered?**

EACH believes that the proposals to set mandatory matching fields seem to go beyond the ESMA mandate under CSDR. In case ESMA finally decides to set mandatory matching fields, EACH believes that the 'trade date' should not be one of the mandatory matching fields for the settlement instructions, because, following the netting process, the 'trade date' cannot always be identified at the level of the settlement instruction. Settlements which are generated as a result of the netting of several transactions within a CCP (particularly, but not exclusively, in relation to repo transactions) do not necessarily relate to a single trade date.

#### Incentives for early input of settlement instructions

**Q5: Do you agree with the above proposals? What kind of disincentives (other than monetary incentives such as discounts on matching fees) might be envisaged and under which product scope?**

EACH believes that CCPs should not be obliged to provide settlement instructions on ISD-2 and ESMA should not introduce disincentives considering the different netting models which are provided by CCPs and used by their Clearing Members. Especially in the case of Actual-Settlement-Day-Netting/Continuous-Net-Settlement, delivery instructions are provided to the CSD shortly before ISD (Intended Settlement Day). Indeed in most cases (e.g. for fixed income securities) the settlement instruction is typically sent to the CSD on either ISD-1 or on ISD itself, corresponding respectively to either a T+1 or T+0 settlement date. Therefore, in many cases a trade which is to be settled on ISD has not yet been executed on ISD-2.

Moreover, following the migration to the T+2 settlement cycle as of 6 October 2014 in the context of T2S, ISD-2 will effectively become the trade date. In the participant chain from *client - executing broker - Clearing Member* there are multiple steps and mechanisms of confirmation which make it very difficult for all settlements to be matched on trade date. For example, some buy-side clients in bilateral OTC transactions may be located in different time zones (US or Asia), and therefore match the next day. The application of disincentives at ISD-2 would lead to high costs, particularly in the equity markets.

In this context implementation of "already matched" instructions by CCPs could be recommended as a best practice.

### **Details of the system monitoring settlement fails (Article 7(14) (a))**

**Q9: Do you agree with the above monitoring system description? What further elements would you suggest? Please present the appropriate details, notably having in mind the current CSD datasets and possible impact on reporting costs.**

EACH encourages ESMA to take into account that the management of settlement fails may be different across European markets according to the netting model in place.

In principle, the granularity of information to be reported seems to be reasonable, however it needs to be considered that whereas monitoring of fails at CSD level is feasible in those systems that track fails separately according to ISD, this might not be the case in systems adopting Actual-Settlement-Day-Netting/Continuous Net Settlement (CNS).

Considering the characteristics of Actual-Settlement-Day-Netting/Continuous Net Settlement (CNS) the corresponding information is only available at CCP level, because:

- Transactions are netted directly before the intended settlement date resulting in technical delivery instructions which are subsequently sent to the CSD (i.e. CSDs only receive information on instructions but not on individual trades).
- Delivery instructions not settled until the end of the settlement date are removed in the CSD for that date and reconsidered in the netting at CCP level for the next settlement day. Hence, internalisation of failed transactions within the originator is possible and the resulting market impact can be reduced.

Furthermore, the monitoring of fails in case of Actual-Settlement-Day-Netting/Continuous Net Settlement (CNS) can only be executed by CCPs and is already in place under the Short Selling Regulation. However, there is no requirement in place to report the fails to the competent authorities.

Considering the characteristics of Trade-Day-Netting the information of single trades is only available at the CCP and only technical delivery instructions sent to the CSD are available for reporting by the CSD. Please consider that those delivery instructions are resulting from the trades of a single trading day and, therefore, can be used for reporting and/ fining by the CSD, if required.

Separately, EACH is of the opinion that a distinction needs to be made between the different entities that are part of the entire process: Trading Members participating on the trading venues, Clearing Members participating in the CCPs and Settlement Institutions/custodians known to the CSDs. The CCP has the information at the Clearing Member level and CSDs have information on Settlement Institution custodian level only. Therefore, ESMA should further define the information that is required to be reported for the purpose of monitoring fails. The information on the different levels has to be distinguished in order to ensure the provision of an appropriate reporting.

Finally, EACH understands that the system monitoring settlement fails will only apply for delivery instructions remaining at the CSD level after the settlement date.**Details of operations of the appropriate buy-in mechanism (Article 7(14)(c))**

**Q13: CSDR provides that the extension period shall be based on asset type and liquidity. How would you propose those to be considered? Notably, what asset types should be taken into consideration?**

EACH welcomes the ESMA proposals to distinguish a longer extension period for certain instruments like ETFs, Bonds, etc. We believe that for these types of instruments, the period should be ISD+7, regardless of whether the instruments are cleared or uncleared. In addition,

**Details of operation of the appropriate buy-in mechanism (Article 7(14)(c))**

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

Currently buy-ins for shares under the EU Short Selling Regulation are executed on S+4 without causing any issue. EACH believes that a 4 business days execution period is feasible for liquid instruments and, no longer execution period is required. In order to fulfil its obligation as a CCP and deliver the financial instruments to the Clearing Member which did not receive delivery on time, EACH prefers to continue with the period of 4 days in respect to liquid assets.

As general rule we believe that the execution period should be equal to the extension period.

However in respect to illiquid shares these are excluded from the prolonged extension period of up to S+7 in the level 1 text (Art 7.5), as opposed to illiquid shares which are not cleared. This results in an unlevelled playing field between cleared and non-cleared shares and an incentive for participants to move away from central clearing.

In this regard the logic that the reduced liquidity of SME shares justifies the extended timetable provided by CSD Regulation should also apply to less liquid cleared securities traded on regulated markets.

Therefore EACH believes that as part of the RTS, ESMA needs to determine an execution period for illiquid cleared shares that mitigates the incentive for participants to move away from central clearing, for instance by aligning, as far as possible, the expiration of the execution period with that of uncleared trades in less liquid securities.

Further flexibility on the execution period for less liquid cleared shares should be granted to registered market makers in those securities where the national competent authority deems it necessary to protect liquidity having regard to the market model.

As for the buy-in procedure EACH would welcome clarification on the possibility for CCPs to avoid the deferral period and opt for cash compensation provided that CCPs, as central counterparty, are considered to act as the receiving and the delivering participant at the same time.

Finally, it should be noted that because of the combination of the settlement regime and the algorithms of the CSDs, some CCPs are used to manage two triggering events with respect to the launch of a buy-in procedure:

- The most usual one is of course when a fail of delivery is older than  $ISD + X$  (4 for instance) and the counterparty(ies) which can be impacted by the buy-in could be waiting for their securities for  $X$  days or less.
- In some circumstances, the buy-in would be triggered by the fact that a buyer is expecting its securities for  $X$  days; in that case the CCP will choose the seller who has the oldest fail on the given securities, the latter being potentially less than  $X$  days.

**Q15: Under what circumstances can a buy-in be considered not possible? Would you consider beneficial if the technical standard envisaged a coordination of multiple buy-ins on the same financial instruments? How should this take place?**

We welcome ESMA's proposal to allow the CCPs to decide whether the buy-in is feasible.

However, the proposal to seek approval by the competent authority on such decision (e.g. because the financial instruments are not available anymore) is, not feasible from a CCPs point of view, considering the time required. Therefore, EACH suggests leaving the decision on the feasibility of the buy-in solely with the CCP, in order to avoid delays that may have a negative impact on the market participants. If ESMA however requires an approval from the competent authority, this should not be required on a case by case basis but be pre-determined in the rules of the CCP in respect of a specific set of instruments (e.g. illiquid instruments) and/or under specific the scenarios (e.g. the security ceases to exist). This will ensure certainty for both the CCP and the market participants and it will avoid adding unnecessary risk to the buy-in procedure.

In addition, if ESMA deems necessary to require the competent authority's approval, the draft RTS should specify that, where the executing party of a buy-in is a CCP, the CCPs' competent authority should be notified, rather than the 'CSD supervisors', as stated in the discussion paper.

The buy-in procedure does not specifically address settlement in relation to repo transactions where settlement is to be achieved via triparty settlement systems such as those supported by Euroclear Bank, Clearstream International and Euroclear UK and Ireland (Delivery-by-value (DBV) and Term DBV). Settlement in a triparty environment has a number of characteristics which are different to that of standard Delivery-versus-payment (DVP) settlement. In particular, the term nature of the settlement (with collateral automatically being returned to the giver at the end of the term) and the ongoing obligation to support mark to market transactions initiated by the triparty provider are significant. In this context the buy-in of collateral would not, in itself, be sufficient to support the settlement transaction on an ongoing basis, particularly in relation to triparty mark-to-market transactions. EACH would like to confirm that the intention of the CSDR and related RTS is that settlements relating to repurchase transactions in triparty environments are excluded from the scope of the settlement discipline regime.

EACH would like to make clear that Article 72a currently foresees that Article 15 of Regulation (EU) No 236/2012 (SSR) will become obsolete with the CSDR coming into effect. Unfortunately, the implementation of the appropriate technical standards will be in place at a later point in time. EACH identifies a potential gap in the overall environment treating CCP cleared shares. As a result, EACH proposes to ensure that an appropriate transitional provision is introduced in order to mitigate this risk. In case no mitigation can be achieved by ESMA, EACH would propose to leave the respective rules in place until the CSD Regulation technical standards will be enforced by ESMA.

**Details of operation of the appropriate buy-in mechanism: operation types and timeframes under which buy-in is deemed ineffective (Article 7(14) (e))**

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

It is unclear whether the exemption for repurchase transactions from the buy-in under Article 7(4)(b) of the CSD Regulation applies to the opening leg or to the whole repo transaction. We would welcome the RTS to clarify that the exemption applies to both the opening and the closing legs.

We agree with ESMA's view that for repurchase transactions, buy-ins will be ineffective where the intended settlement date of the opening leg of the repo plus the extension period and execution period of the buy-in is equal to or later than the intended settlement date of the return leg of the repo transaction.

**Calculation of the cash compensation (Article 7(14) (f))**

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

With respect to cleared transactions, ESMA should take into account that for cleared trades a single failed settlement instruction may be the net of many trades from many trade sources. Therefore the RTS should clarify that for cleared transactions CCPs would need to determine the security price at their discretion for the purpose of calculating the cash compensation, rather than rely on the original trade source. Due to the multilateral netting by a CCP it is also likely that the net consideration of the selling party does not match that of the buying party – i.e. the equivalent 'trade price' is different on each side of the fail. Reference to the original trade price and original trade source cannot, therefore, be applied to CCP's multilateral net settlements and compensation calculation. The reference price is generally the last available closing price (as used in margin calculation) or any other price depending on the specific circumstances at the discretion of the CCP for the reasons set out above.

**Conditions under which a participant is deemed to consistently and systematically fail to deliver the financial instruments (Article 7(14)(g))**

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

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

We would invite ESMA to clarify if the quantitative thresholds will be calculated on the value/number of the settlement instructions of a failing participant cleared with a CCP or to the total value of settlement instructions across all venues (i.e. trading venues, CSDs, CCPs).

Due to the large difference in the value of settlements for each clearing member across different asset classes within a CCP, we suggest CCPs calculate a separate fail percentage for each clearing member per clearing service. The CCP will then be able to suspend a participant in relation to its activity in a particular clearing service where it fails consistently, without impacting its activity in another clearing service.

**Necessary settlement information (Article 7(14)(h))**

**Q20: What is in your view the settlement information that CSDs need to provide to CCPs and trading venues for the execution of buy-ins? Do you agree with the approach outlined above? If not, please explain what alternative solutions might be used to achieve the same results.**

EACH members believe that at the moment CCPs and CSDs already exchange the necessary information and therefore there is no need for the RTS to provide any further requirements.

**Section III.II CSD Authorisation**

**Reasons which may justify a refusal of access to other market infrastructures and the procedure in case of refusal (Article 53(4) and (5))**

**Comment to Paragraph 223**

EACH believes that CCPs should be granted the same rights of the CSDs' in terms of refusal of access to other market infrastructures. The refusal procedures noted in para 223 of the discussion paper should also apply to all parties requesting access. EACH welcomes the RTS to clarify this point.

**-END-**

## About EACH

European central counterparty clearing houses (henceforth CCPs) formed EACH in 1991. EACH's participants are senior executives specialising in clearing and risk management from European CCPs, both EU and non-EU. Increasingly, clearing activities are not restricted exclusively to exchange-traded business. EACH has an interest in ensuring that the evolving discussions on clearing and settlement in Europe and globally, are fully informed by the expertise and opinions of those responsible for providing central counterparty clearing services.

EACH has 20 members:

|   |  |
|---|--|
| ATHEX Clear S.A.                                | irgit S.A. (Warsaw Commodity Clearing House) |
| BME Clearing S.A.                               | KDPW_CCP S.A.                                |
| CC&G (Cassa di Compensazione e Garanzia S.p.A.) | KELER CCP                                    |
| CCP Austria                                     | LCH.Clearnet Ltd                             |
| CME Clearing Europe                             | LCH.Clearnet SA                              |
| CSD and CH of Serbia                            | NASDAQOMX Clearing AB                        |
| ECC (European Commodity Clearing AG)            | National Clearing Centre (NCC)               |
| EACH AG   | OMIClear                                     |
| EuroCCP   | Oslo Clearing ASA                            |
| ICE Clear Europe                                | SIX x-clear AG                               |

This document does not bind in any manner either the association or its members.

### Contact

Rafael Plata

[rafael.plata@eachccp.eu](mailto:rafael.plata@eachccp.eu)

+32 (0)27208062