RE: ESMA Discussion Paper on Central Securities Depositories Regulation

Dear Sirs,

BlackRock is pleased to have the opportunity to respond to the Discussion Paper on Central Securities Depositories Regulation (CSDR).

BlackRock is a premier provider of asset management, risk management, and advisory services to institutional, intermediary, and individual clients worldwide. As of 31 March 2014, the assets BlackRock manages on behalf of its clients totalled €3.2 trillion across equity, fixed income, cash management, alternative investment and multi-investment and advisory strategies including the iShares® exchange traded funds.

BlackRock has a pan-European client base serviced from 22 offices across the continent. Public and private sector pension plans, insurance companies, third-party distributors and mutual funds, endowments, foundations, charities, corporations, official institutions, banks and individuals invest with BlackRock.

BlackRock represents the interests of its clients by acting in every case as their agent. It is from this perspective that we engage on all matters of public policy. BlackRock supports policy changes and regulatory reform globally where it increases transparency, protects investors, facilitates responsible growth of capital markets and, based on thorough cost-benefit analysis, preserves consumer choice.

By way of general comments, we would encourage ESMA to provide a consistent regulatory framework across Europe in matters such as buy-in regimes. We attach importance to levelling the playing field across Europe with legislation such as the CSDR. To avoid regulatory arbitrage and related post-trade technical challenges, we would encourage ESMA to design the rules for CSDR implementation to allow for very limited, if any, scope for individual Member States to deviate from the ESMA standard. This principle is particularly important for ETFs that are cross-listed in several European jurisdictions. Establishing the same buy-in procedures or fail penalties notwithstanding the trading, clearing or settlement venue would facilitate the European Single Market whilst providing end-investors consistency of outcome and eventually reduced cost. That harmonisation can only be effective if the penalties are only issued by one part of the Market Infrastructure (i.e. the Trading Venue or the CCP or the CSD). Currently there can be multiple levels of penalty fails in addition to different failed trade regimes, resulting in distortions across European capital markets.

Our detailed responses to the questions follow in attachment. We welcome the opportunity to address, and comment on, the issues raised by this consultation and we will continue to work with ESMA on any specific issues that may assist in developing the CSDR.

Sincerely,

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Answers to Specific Questions in the Discussion Paper

We have focussed on the questions which are most relevant to BlackRock as either a buy-side market participant across the range of asset classes and/or as an issuer of ETF securities in European markets.

Settlement Discipline

Q1: Which elements would you propose ESMA to take into account / to form the technical standards on confirmation and allocation between investment firms and their professional clients?

We understand the Level 1 requirements on allocation as referring mainly to orders executed by asset managers as blocks on behalf of a number of underlying sub-accounts for which the allocation to the individual sub-accounts would be communicated later in the day and sometimes the following day. We would appreciate ESMA’s view on this interpretation since occasionally asset managers will trade for accounts for which a sub-account has not yet been set up with the executing broker. This causes delays as the executing broker then has to obtain all of the relevant information to set up the account and allocate a portion of the trade to that sub-account.

Provisions to deal with this scenario are already contained in the Dodd Frank Act in the US, requiring that allocations of trades to individual sub-accounts be communicated by the end of the trading day in which the block was executed. We believe that these provisions would form a good basis for the elements ESMA should take into account to form the technical standards on confirmation and allocation between investment firms and their professional clients.

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?

Yes, we share ESMA’s view.

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?

We agree with ESMA’s proposal. We seek clarity however regarding how the CSD would know that the settlement instructions could have been submitted before the end of Intended Settlement Date (ISD) -2.

Q6: In your opinion, should CSDs be obliged to offer at least 3 daily settlements/batches per day? Of which duration? Please elaborate providing relevant data to estimate the cost and benefit associated with the different options?

Yes, CSDs should be obliged to offer at least three daily settlements / batches per day to maximise the opportunities for settlement but our preference would be for as close to real time settlement as possible. If assets are on loan or pledged as collateral, the intra-day settlement opportunities become extremely important to ensure reduced fail activity and maintain market efficiency.

Q7: In your view, should any of the above measures to facilitate settlement on ISD be mandatory? Please describe any other measure that would be appropriate to be mandated.

Partial settlement and recycling of settlement instructions should be mandatory as they seem to have the biggest potential to facilitate settlement on the ISD.

Q8: Do you agree with this view? If not please elaborate on how such arrangements could be designed and include the relevant data to estimate the costs and benefits associated with such arrangements. Comments are also welcome on whether ESMA should provide for a framework on lending facilities where offered by CSDs.

While the idea of an auto-borrow and auto-loan is a good one in theory, it could give rise to some practical difficulties. This would particularly be the case for ETFs, given that they are held across many different CSDs hence the ability to effectively lend or borrow ETFs is currently very limited. If an auto-borrow / auto-loan process was to be adopted, it would need to be closely linked to seamless fungibility between inventories held in the various CSDs.
The specific proposal of lending facilities also raises a number of questions:

1. Under what documentation would the loans be made? The use of documentation other than the market standard documentation may impact the parties' ability to net their exposures etc.

2. Depending on the terms / costs of loans under these facilities, they may compete with existing lenders in the relevant markets, for example if borrowing ‘specials’ through one of these facilities is cheaper than borrowing them in the lending market, may short sellers decide to trigger one of these loans?

3. How would concentration limits (or other restrictions to be observed by lenders) be monitored under these facilities?

4. How would the existence of such facilities impact the buy-in process? How long before a failing party is bought in?

5. Would participation in these facilities be elective or mandatory?

In the light of the questions above, we would agree that lending facilities should not be mandated and ESMA should not provide for a framework on lending facilities.

Details of the system monitoring settlement fails

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 data sets and possible impact on reporting costs.

Whilst it would be appropriate to identify the issuer, we question the purpose of identifying the failing party, especially as this may be the last in a long chain of fails. We would encourage ESMA to justify the rationale behind this.

It would also be helpful for ESMA to clarify the definition of the issuer in this case and in particular if this would be the issuer of the instruction. Most settlement activity would be secondary market so not connected with the actual issuer of the shares.

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

In our view, participants should have real-time access the status of any activity they have alleged into the CSD or is alleged against them. The CSD should be able to electronically distribute settlement information to, or interface with, participants so that this can be further disseminated through their client base as close to real time as possible.

This section raises a number of additional questions, for example at what stage would information about the failed instructions be communicated – when they have failed to match or later? Would the market participant not be aware of the settlement fail (or earlier, of the failure to match) anyway? We would encourage ESMA to further reflect on these points.

Q11: Do you believe the public information should be left to each CSD or local authority to define or disclosed in a standard European format provided by ESMA? How could that format look like?

We would strongly encourage a standard European format. This would be an important step towards the development of a European single market in settlement and importantly, facilitate meaningful comparability of information between CSDs.

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?

This issue raises a number of questions:
(1) How would ESMA determine a “typical bond transaction”? Different bonds have very different trading patterns or even no patterns at all. The same bond may trade very differently at different times during its lifecycle (e.g., immediately after issuance vs. later on in its lifecycle).

(2) How would ESMA determine “current market practices” for government bonds? We do not believe that longer extension periods for government bonds would be justifiable.

(3) Extension periods should consider the size of the failing trade too and take into account the potential market impact of the fail. Would this already be taken into account under ESMA’s notion of “liquidity?” Finally, having consistent buy-in timelines for ETFs and equities is our strong preference. The question that may be raised is how this could be achieved, especially given the cross border settlement issues in the ETF market, which arise due to market fragmentation in Europe. The reason is that ETF market makers and to a certain extent broker dealers, could access the primary market in order to fulfill their short position. This would add to their costs but it does mean they could still settle before the buy-in process commences.

Details of operation of the appropriate buy-in mechanism

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?

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?

In response to question 14, although for some liquid products such as equity and some government bonds the aspirational buy-in execution period could be two business days, four business days is the appropriate period to institute a buy-in for ETFs. As mentioned above there is the ability to access the primary market within that time. If a product is bought back on exchange during the extension period that should be offset against any amount that is eventually bought-in.

In response to Q15 a possible way to coordinate multiple buy-ins in the same financial instruments would be to appoint the same intermediary to execute the buy-in, so that it could measure the impact on the market and would not compete in the market with other buy-in agents.

Finally, we would be grateful if ESMA could clarify a number of points arising from this section:

- Paragraph 54 – it isn’t clear why the first bullet refers to the “end of the market day following the intended settlement date (ISD) or the following day”. ESMA should consider why this couldn’t be immediately after ISD is passed.
- Paragraph 55 - “the receiving participant has to accept the bought-in securities” provided it is a tradable size. Presumably a buy-in will only deliver a tradable size, but we would suggest this is specified.
- More generally, leaving the CSDs to decide on the buy-in feasibility would introduce fragmentation of approaches in the market. ESMA should set out why it deems it inappropriate to harmonise this aspect.

Details of operation of the appropriate buy-in mechanism: operation types and timeframes under which buy-in is deemed ineffective

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

Buy-ins would be ineffective for the first leg of such trades, which covers all instances where the term of the trade would be less than one week. It is worth noting however that securities lending and repo master agreements already provide for remedies between the parties. A regime external to the master agreement does not seem necessary and may introduce undue complexity.

1 Unless the size of the buy-in (including when multiple buy-ins in the same security are aggregated) warrants a longer period to mitigate market impact.
Regarding forward trades, we would recommend that the pricing implications be considered. Where there is the option to cancel trade it would be appropriate to consider the compensation offered.

**Calculation of the cash compensation**

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

Compensation for the difference between the price traded and the price at the time of buy-in is insufficient. There should be a punitive amount in addition to ensure settlement discipline. This might also allow for the fact that, in circumstances where it is not possible to buy-in a security, a market participant should pay more than the last traded price to close the position. Paying cash compensation only when the price of the financial instrument agreed at the time of the trade is lower than the last publicly available price will not lead to better settlement discipline, in our view. Importantly, this penalty should be consistently applied across Europe.

In general, the recipient should be in the same position as it would have been if it had received the securities on the ISD. This means that if a dividend record date occurred on or after ISD and during the fail period the recipient should be put in the position that it would have been if it had received the securities on ISD.

**Conditions under which a participant is deemed to consistently and systematically fail to deliver the financial instruments**

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

We agree that instrument type should be factored into the consideration as to whether the failure rate is excessive-some products are more prone to failing than others (arguably ETFs are an example of such products because of the cross-border settlement issues which currently arise due to market fragmentation).