

**Clearstream response to the  
ESMA Discussion Paper on the**

**Draft Technical Standards for the Regulation on improving securities  
settlement in the European Union and on central securities  
depositories (CSDs) and amending Directive 98/26/EC**

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## A. Introduction

Clearstream Banking AG, Frankfurt and Clearstream Banking S.A., Luxembourg (jointly referred to as Clearstream) appreciate the opportunity to comment on ESMA Discussion Paper on the draft technical standards for the regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC.

As a wholly owned subsidiary of Deutsche Börse Group, Clearstream is one of the world's leading suppliers of post-trading services including settlement, safekeeping, and administration of securities, Clearstream has welcomed all along the core objective of the CSD regulation to develop a single proper regulatory framework for CSDs and to harmonise certain aspects of the securities settlement in the European Union.

CSDs have proven their resilience during the financial crisis, while playing a stabilising role on the financial markets. There were no problems stemming from any of the ancillary services offered by CSDs to the market. This has been a test for the European CSDs that has proven the appropriate implementation of sound and safe risk management procedures established for many years now under the CESR/ESCB recommendations, CPSS-IOSCO Principles and several other global best-practice standards.

The innovation and constant reinventing by this industry should be acknowledged, ESMA should avoid scoping or creating an exhaustive list among the Regulatory Technical Standards (RTS) it aims to propose to the Commission, which would leave no room for product and services innovation. Moreover, technical standards for companies offering CSD services, needs to be adequate and not over burdensome for the sake of preserving growth in an industry which is a success story for Europe, and ensuring a level-playing field with the rest of the world.

## B. Summary of key concerns on the proposed regulation

- The discussion paper elaborates largely on the risk aspects that technical standard should specify. Particularly the conditions under which the competent authorities may approve CSD functions, and the different ways in which risks should be assessed. Considering that the CSD Regulation follows the risk principles defined by the CPSS-IOSCO Principles for financial market infrastructures (PFMI), and considering the very lengthy and thorough **CPSS-IOSCO assessments and disclosure requirements** set in those principles, we are very surprised to find out that discussion paper makes no use or reference to such elements in its proposals. Clearstream believes, future technical standards should leverage existing information produced by the CSDs to comply with regulation, and not duplicate this effort.

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- On the technical standards relating to the **CSD links**, the discussion paper elaborates on the risk aspects that technical standard should develop. The **ECB has been enforcing standards for the use of SSSs in Eurosystem credit operations** since 1998 (and updated in 2014). A positive assessment against these “**user standards**” allows SSSs and links between SSSs (as provided by CSDs) to be considered eligible for use in Eurosystem credit operations. Once again we are very surprised to find that discussion paper makes no reference to these well-established standards in its proposals, nor dwells on the work already performed by the Eurosystem in assessing the CSD links.

Future technical standards should leverage on existing information produced by the CSDs to comply with regulation, and not duplicate this effort.

- The backbone of the upcoming ESMA technical standards should be to promote CSD stability throughout the EU, **technical standards applicable to CSDs should weight the costs these will imply in proportion to the stability benefits they may provide**. In no circumstance should technical standards effectively serve as an insurance policy to conceal objectives not covered in this or other pieces of legislation.

- **Double regulatory requirements need to be avoided**. In our view, this is necessary not only to avoid burdensome rules and requirements, but also to avoid the application of conflicting standards to CSDs, their links and their cross-border operations depending on whether these are in or out of the Eurosystem, or in or out of a direct holding jurisdiction.

- Finding the right balance for some tasks is not always easy task, we note however that for some proposals, the discussion paper proposals might go a bit **beyond the scope of the level-1 requirements**. Examples of this are referred to in our comments under Q4 on “standardised matching fields” and in Q7, Q21, Q27, Q28 on “recordkeeping” and Q29.

- On settlement discipline, **given their inherent low risk profile, CSDs should in principle not be involved in the execution of buy-ins** (or the buy-in process as a whole) which is primarily the responsibility of CCPs. Similarly, on financial incentives or penalties, the CSDs role must remain optional and subject to the local market performance and needs.

- Disclosure to competent authorities and to the general public has been a common practice by the FMs for years now. Transparency is a governing principle of our industry. We note however that the discussion paper elaborates largely (particularly in the annexes) in information which should be provided in duplicate form to the current transparency obligations (website disclosure or reporting to the regulators) of CSDs to the competent authorities for the different procedures. ESMA should embrace the benefits of this transparency and request a **simple reference to the website where this information is published** and regularly updated.

- The recent experience of implementing EMIR and its technical standards should provide examples of processes and tasks which have resulted overly complicated or engineered to put into practise. Examples of this can be found in the authorisation processes and the collegial structures among regulators involved.

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### C. Answers to the specific questions raised in the Discussion Paper

#### 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?**

Unlike trading venues and investment firms, CSDs are not directly in the scope of article 6(1) on trade confirmation. We thus do not comment on question 1 of the Discussion Paper.

**Q2: In your opinion, are there any exceptions that should be allowed to the rule that no manual intervention occurs in the processing of settlement instructions? If so please highlight them together with an indication of the cost involved if these exceptions are not considered.**

Automation and the promotion of straight-through processing (STP) is core to the CSD business. We agree that all processes should be designed to function on an STP basis "by default", but we caution ESMA against imposing STP or limiting explicitly the number and type of cases when manual intervention is allowed.

**Limiting manual intervention will result in reduced settlement efficiency and therefore will reduce liquidity and collateral velocity, which are two very important objectives pursued by regulators and market participants in other regulatory workpieces.**

Indeed, as in most businesses, manual intervention is needed on occasion, in particular where corrective actions are required, or in times of crisis. There is no need for ESMA to restrict manual intervention in regulatory technical standards, especially given the difficulty of defining "manual intervention" (would this refer to interventions made by the CSD or by CSD participants? Does access to a CSD's graphical user interface count as manual intervention?) and the multiplicity of cases when such intervention might be required to ensure timely settlement (often in exceptional circumstances).

For example, for some OTC transactions, CSD participants manually amend their instructions to reflect information received from their own clients (e.g. using an MT599 message) instead of having to cancel and re-instruct in the settlement system. Manual processes are also sometimes needed for corporate actions, redemptions/coupon payments, stripping instructions or the handling of bankruptcies and similar exceptional circumstances. Settlement via direct links can, depending on the respective CSD system, also require some manual intervention for the CSD and/or its participants.

Furthermore, Standard 11 of the ESSF-ECSDA Matching Standards foresees that the instruction process in the CSD should enable the 'amendment' of instructions in non-matching relevant areas rather than the cancellation and resubmission of the trade. Such flexibility supports the smooth processing of instructions and should be preserved.

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We believe that ESMA standards should encourage automation whenever this increases the efficiency and safety of the system. But mandating automation and limiting the type of exceptions (such as "manual intervention") in Level 2 legislation could be counterproductive and actually reduce settlement efficiency, removing all flexibility for CSDs and their participants. CSDs must have full discretion as to when manual intervention is necessary.

In line with the response of the T2S community to ESMA, we insist that manual intervention should be allowed in the CSD rules of procedures.

Besides, it should be noted that STP at CSD level is also dependent on the level of automation of CSD participants and linked infrastructures. For instance, implementing "already matched" functionalities whereby the trading or clearing infrastructures use a Power of Attorney to instruct the CSD on behalf of participants is a good way to promote STP and reduce the likelihood of fails. These functionalities can also help achieve compliance with article 6(1) requiring trading venues to "establish procedures that enable the confirmation of relevant details of transactions".

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

ESMA regulatory technical standards could seek to encourage the use of communication procedures and standards that facilitate STP, in line with the CPSS-IOSCO Principles for financial market infrastructures. However, **Level 2 legislation should not mandate the use of specific communication standards (e.g. ISO 20022): this would not only be disproportionate, but it would also "lock" the rules with the standards in use at a given time and cause problems once the standards evolve into new ones.**

At most, **ESMA could introduce a general reference to "international standards" in the technical standards**, but a more precise reference to individual standards (such as ISO15022 or ISO20022) should be avoided. Indeed:

- ISO standards do not cover all functionalities and services offered by CSDs and in some cases, limiting CSD communication standards to ISO standards would result in the discontinuation of some services that are helpful to market participants and support an efficient settlement process. Examples include messages for static data, certain reports including settlement discipline related reporting, the SBI trade confirmation service in the French market, communication of end investors details in the Spanish market, cash settlement forecasts in the Polish market, as well as many of the account level services offered by CSDs in direct holding markets.
- Technical standards for other infrastructures (trading venues and CCPs) do not go into this level of detail, and there is no reason to adopt a prescriptive approach on communication standards for CSDs.
- In some cases, other communication standards than ISO standards might be appropriate to enhance settlement efficiency and STP, in particular for CSDs not participating in T2S. In such cases, local standards should be allowed, on the condition that they are publicly available.

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Furthermore, we note that the scope of article 6(2) is restricted to the settlement process, while in practice CSDs will look to develop automated processes and use harmonised communications standards for other processes as well, such as the maintenance of securities accounts. Introducing overly detailed requirements on communication standards for settlement in Level 2 legislation could thus be counterproductive if it hampers CSDs' ability to adopt a holistic approach to support STP for all their processes and activities.

All in all, Clearstream does not believe that technical standards aiming to implement CSD-R article 6(2) need to cover automation and communication standards, especially given that article 35 of the Regulation already covers communication procedures and is not subject to Level 2 legislation. We believe that standards on matching processes (see thereafter) would be more appropriate to fulfil ESMA's mandate under article 6(4).

**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?**

*(a) Compulsory matching*

We agree with ESMA that, for transactions which have not been matched by a trading venue or a CCP, matching should be compulsory at CSD level, but we believe more exceptions need to be considered, in particular:

- in the context of corporate actions processing;
- for certain free of payment (FoP) transfers among securities accounts managed by the same CSD participant, and not necessarily "opened in the name of the same participant" (see below);
- in the context of multilateral systems without CCP intervention (i.e. when instructions are not entered into the settlement system by the CSD participants, but are received via a trade feed);
- when instructions are processed as a result of a Court order (e.g. insolvency proceedings).

Clearstream agrees with ESMA that FoP instructions between accounts opened in the name of the same participant should be excluded from the compulsory matching requirement since these are typically collateral movements, portfolio transfers or account allocation movements, especially in direct holding markets. Nonetheless, we believe that the phrase "accounts opened in the name of the same participant" should be replaced by "accounts managed by the same participant" in order to cover all direct holding models.

Indeed, in direct holding markets, securities can be held in accounts belonging to end investors / customers of the CSD participant, not on the CSD participant's account. As a result, a transaction on behalf of an end investor can be effected in one of the following ways:

(a) Securities may be transferred directly from the account of a customer of Participant A (or from Participant A's account) to the account of a customer of Participant B; or

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(b) Securities can be transferred from the account of Participant A to the account of Participant B in one transaction, and then Participant B can instruct another transaction between its account and the account of its customer.

In scenario (b), the second transaction allocating securities from Participant B's account to the account of the customer of Participant B is only effected by one participant, and so compulsory matching is not feasible. The same applies to other transactions between accounts managed by the same CSD participant (collateral movements, portfolio transfers etc.).

Importantly, the account of a Participant's customer can either be an account for which the Participant is the account operator (as mentioned under CSD-R article 31) or an account on which the Participant has been given a Power of Attorney. In the latter case, the account is managed by the same Participant, but might have been opened in a different name from that of the Participant (e.g. directly in the Participant customer's name). It is thus important to extend the exemption from compulsory matching for all FoP instructions between accounts managed by the same Participant.

Provided these conditions are recognised in the upcoming technical standards/delegated acts, Clearstream would not oppose a general requirement for compulsory matching in the CSD-R technical standards. We note however that today, in some countries (BE, DK, FR, NL, NO), FoP instructions do not always require matching and that this will constitute a change in market practice for CSD participants.

### ***(b) Continuous matching***

Most CSDs already offer real-time matching throughout business day, in line with the ESSF-ECSDA Standard 3. CSD-R technical standards should include a general requirement for CSDs to offer matching possibilities throughout the business day, as a means to facilitate early matching and timely settlement.

We note, however, that requiring real-time matching to be provided by all EU CSDs during the day will require system changes in some markets (BG, CY, GR) and that sufficient time should be given to these markets for making the necessary adaptations.

### ***(c) Standardised matching fields***

There is no need for technical standards to go as far as mandating the use of certain matching fields (e.g. in line with T2S matching fields). In any case, technical standards should not contain a direct reference to TARGET2-Securities, and any requirement should take into account the needs and circumstances of non-T2S CSDs. For example, there is a mandatory T2S matching field called "CSD of the counterparty", but this field will not be relevant in a pure domestic context outside of T2S, and should thus not be mandatory. Moreover, even T2S participating CSDs need flexibility to use matching fields for their internal transactions to allow the provision of additional services to their participants, for example, to prevent cross-matching. Finally, it is also worth noting that T2S matching fields are still under discussion and subject to changes in the future, based on further project developments. 'Fixing' compulsory matching fields in Level 2 legislation would thus create considerable (and unnecessary) constraints by requiring a revision of the law every time there is a need for updating the rules on compulsory matching fields.

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Clearstream recalls that Standard 1 of the ESSF-ECSDA matching standards (2006) already contains a list of harmonised matching fields and that there is no need to create additional binding requirements. In fact it is important that CSDs can retain flexibility in using other matching fields, including optional fields, so as to adapt to local market reality (e.g. end investor information in direct holding markets). Client codes should remain an optional matching field. Mandating the use of certain matching fields would, according to ECSDA, go beyond the mandate given to ESMA under the Level 1 Regulation, and is unlikely to bring substantial benefits in terms of reducing the level of settlement fails.

*(d) Use of matching tolerance amounts*

In order to facilitate the matching process and timely settlement, many CSDs have introduced a “tolerance amount” which, according to ESSF-ECSDA Standard 17, should not exceed EUR 25. CSDs also have the option to use a lower tolerance threshold of up to EUR 2 for retail-sized transactions (below EUR 100,000).

According to a 2013 survey by ECSDA<sup>1</sup>, at least 9 CSDs have a EUR 25 threshold in place today, 12 CSDs use a lower amount, and 8 CSDs have EUR 0 tolerance. Sometimes in the latter case, the CSD offers the matching tolerance functionality in its settlement system but the amount is set at 0 at the request of participants.

Should CSD-R technical standards recommend the use of matching tolerance amount to facilitate timely settlement, we believe that the standards should allow CSDs to determine the appropriate optional tolerance amount in consultation with their participants, from EUR 0 up to EUR 25 (or approximate counter value in the relevant currency).

The use of a different tolerance amount for retail-sized transactions should remain optional. Today, only 5 CSDs apply a different threshold for retail-size transactions: CSD Prague (CZK 50 instead of CZK 600), Euroclear Finland (EUR 2 instead of EUR 25), KDPW (PLN 8 instead of PLN 100), KDD (EUR 2 instead of EUR 25) and Euroclear UK and Ireland (GBP 0 instead of GBP 10 since members can opt out of matching tolerance for retail transactions).

**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?**

*(a) Financial disincentives for the late input of settlement instructions*

The difference between the measures covered under article 6(2) and article 6(3) of the CSD Regulation is not entirely clear from the Level 1 text, but Clearstream understands that **article 6(3) aims to focus on incentive measures**, whether for early matching or early settlement. Early matching or early settlement means that instructions are communicated to the CSD, whenever possible, early on or before the business day rather than just before the applicable deadline.

<sup>1</sup> See the ECSDA report on matching harmonisation published in November 2013: [http://www.ecsda.eu/uploads/tx\\_doclibrary/2013\\_11\\_18\\_ECSDA\\_Matching\\_Report.pdf](http://www.ecsda.eu/uploads/tx_doclibrary/2013_11_18_ECSDA_Matching_Report.pdf)

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Different incentives can be developed to encourage market participants to instruct early in the business day or before, but such incentives are typically market-specific and cannot necessarily be generalised. De facto, the existence of a late settlement penalty regime (under article 7) already constitutes a strong disincentive to settle late and thus also to instruct late, since this increases the likelihood of a fail. Very few CSDs (FR, SE, UK) have established financial incentives for early matching, and there is no evidence that these markets have greatly improved settlement rates compared to those markets where no such incentives exist. Given the high matching rates in other markets that do not have such financial incentives in place, it is doubtful whether the compulsory introduction of a late matching fee in all EU markets would have any benefits<sup>2</sup>.

The introduction of a late matching fee or other financial ‘disincentive’ for late matching should thus be only one tool, among many others, that a CSD can adopt if this is appropriate to enhance settlement efficiency given the local market circumstances (e.g. if the CSD observes that too many participants tend to instruct late in the day). Besides, the moment an instruction is matched often does not depend only on the CSD participant but also on the relevant processes in the CCP and/or trading venue involved. In such cases, late matching fees are not an appropriate tool. And, even when a surcharge for late matching is applied, it must take into account special cases, e.g. exemptions might be needed for certain financial instruments like repos that settle same day and for CCP-cleared transactions. The case of CSDs not offering night-time settlement and the impact of the T2S tariff structure<sup>3</sup> for T2S-participating CSDs should also be taken into account.

We also note that, when applicable, a late matching fee should take the trade date and the settlement cycle into account (for example, defining “late matching” as “matching completed after trade date” rather than on “ISD-2”). Otherwise there would be an incentive for brokers to use, where possible, longer settlement cycles in order to benefit from early matching discounts (for transactions not falling under the T+2 obligation under CSD-R article 5).

ECSDA thus does not agree with ESMA’s suggestion that “settlement instructions which are not received by the CSD by the end of ISD-2 should be subject to disincentives by the CSD”, if this means that all CSDs would be required to apply financial disincentives to instructions matched or input late, even if these settle on time. **Generally speaking, the details of a CSD’s tariff structure, including disincentives for late matching/late input of settlement instructions, should not be imposed by law. A progressive tariff structure is only one means of promoting early settlement and should not be imposed in those markets where no need has been identified.** CSDs should be allowed, but not obliged to, use a progressive tariff structure.

***(b) Hold/release mechanism and bilateral cancellation facilities***

In §24 of the discussion paper, ESMA suggests that “*in order to incentivise early matching, CSDs should offer hold/release and bilateral cancellation facilities, without prejudice of the Settlement Finality Directive provisions*”.

<sup>2</sup> For more details, see [http://www.ecsda.eu/uploads/tx\\_doclibrary/2011\\_07\\_07\\_ECSDA\\_Fails\\_Report.pdf](http://www.ecsda.eu/uploads/tx_doclibrary/2011_07_07_ECSDA_Fails_Report.pdf)

<sup>3</sup> T2S will introduce a surcharge of EUR 0.15 on “intended settlement date failed transactions” from 2015 onwards, and the tariff system for T2S will contain a differentiation between night-time and day-time processing.

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Some ECSDA members already offer a hold/release functionality to their participants, and T2S CSDs in particular are expected to offer such a mechanism, in line with ESSF-ECSDA Standard 9. There are however different aspects to a hold and release mechanism and some CSDs only provide for part of the service (e.g. possibility to release an instruction put on hold, but not necessarily to put on hold an instruction already released), often due to a lack of demand by market participants.

**We believe that regulatory technical standards should not mandate such specific technical functionalities, which are anyway difficult to define in legislation and are unlikely in themselves to significantly reduce the number of settlement fails.** We however recognise that CSDs should be encouraged to offer a hold/release mechanism as a best practice if there is a demand from their participants.

Though ESSF-ECSDA matching standard 6 does not impose the use of bilateral cancellation facilities once instructions are matched, we recognise that such facilities are a best practice that will eventually be enforced by the T2S "bilateral cancellation principle" aiming at:

- eliminating any legal risks of settlement revocability in cross-CSD settlement,
- achieve a level-playing field in this sense, and
- ensure the timely settlement of transactions and settlement fails avoidance.

Therefore, we are of the opinion that CSDs shall be required to apply the bilateral cancellation principle regularly and independently from the CSD-link model.

### *(c) Informing participants about unmatched instructions*

In §25 of the discussion paper, ESMA suggests that *"CSDs should develop a procedure to inform participants about pending settlement instructions of counterparties. Participants should be able to know that their instruction did not match the reason why. This information could be made available by the CSD within 30 minutes maximum, or similar cap after the first unsuccessful matching attempt; and at the beginning of ISD."*

Clearstream agrees that **CSDs should provide their participants with up-to-date information on the status of their pending instructions**, whether in "push" mode (e.g. reporting) or "pull" mode (e.g. access to the matching status of an instruction via an online interface or upon request). **However we do not think that the detailed modalities on how this information needs to be accessed should be specified in Level 2 legislation** (e.g. within  $x$  minutes, with what kind of message/interface). The practical modalities typically depend on the technical design of each CSD's system and on participants' preference based on the costs involved. The most important thing is that participants should have an easy access to such information.

Importantly, ESMA should recognise that those **CSDs are not always in a position to identify the reasons why an instruction has not been matched**. Requiring the CSDs to investigate the causes of an unmatched instruction would potentially require manual intervention and expose the CSD to legal risks. CSD participants are best placed to understand the business context in which a transaction has failed to match. In the T2S platform, for example, CSDs may be able to check whether a settlement instruction is matched, but they will not receive information on the underlying cause why an instruction is not matched.

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As a result, CSD-R technical standards should contain a general requirement for CSDs to allow participants to access the matching status of pending instructions. But technical standards should not go as far as:

- requiring CSDs to identify and provide information on the causes for unmatched instructions;
- specifying the detailed modalities (timing, format) for providing such information.

*(d) Other tools to incentivise early settlement*

Some CSDs (e.g. AT, FR) offer pre-matching facilities which also encourage participants to match early. As with other types of incentive measures, such facilities should not be mandated in regulation but rather be allowed so that they can be adopted in those markets where a need has been identified.

We also note that, outside of the CSD environment, the encouragement of the use of automated trade confirmation mechanisms can assist in early matching and hence early settlement.

**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.**

Clearstream agrees with the general analysis provided by ESMA in §26 to 29 of the Discussion Paper, but we are however not convinced about the penultimate sentence of paragraph 29 suggesting that *“all CSDs should be obliged to offer at least three daily settlements (batches), unless they operate on an RTGS basis”*.

Today, some European CSDs work with batches for securities settlement and some of them have less than 3 settlement batches a day, usually because there is no market demand. **In the absence of any evidence that this will reduce settlement fails, Clearstream does not think that ESMA should mandate a specific number of batches per day.**

Should ESMA however consider imposing the use of 3 settlement batches per day as a minimum requirement in the future, it is essential that CSDs be given sufficient time, i.e. at least 5 years, to implement the change, given that this would require considerable investments and, in some cases, the implementation of an entirely new system.

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

The technical functionalities listed by ESMA in §30 of its Discussion Paper are used by CSDs to facilitate timely settlement are part of a “toolkit” that cannot be mandated for all CSDs in all cases. Generally speaking, CSD-R technical standards should ensure that CSDs are allowed to pick the most appropriate tools to enhance settlement efficiency in their market, but should not seek to mandate specific tools when there is no evidence that such tools would substantially benefit settlement efficiency at European level.

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For example, **mandating the use of technical netting and other optimisation algorithms, partial settlement or trade shaping functionalities, is clearly not justified and would go beyond the Level 1 mandate granted to ESMA.** Such functionalities are not always required in a given market, and for example the shaping of trades is not a functionality offered in TARGET2-Securities, and, if provided at all, can in fact be more efficiently provided at the level of the CCP or trading venue, rather than at CSD level.

Taken into account the fact that:

- The level of settlement efficiency in Europe is already close to 100%,
- The majority of EU CSDs have joined T2S,
- T2S will provide functionalities such as optimisation algorithms (technical netting), partial settlement, and the recycling of instructions,

**It is unnecessary, burdensome and costly to require CSDs to develop these functionalities.**

**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 pro-vice for a framework on lending facilities where offered by CSDs.**

Securities lending and borrowing (SLB) facilities should not be mandated in technical standards but should rather be considered as one possible option to prevent settlement fails. SLB facilities (where the CSD acts as agent between lenders and borrowers) are offered by CSDs today in some markets, but not all CSDs should be expected to develop a central facility. The costs of implementing a central system will not always be justified, and it is worth noting that some of the largest markets in Europe (e.g. UK, FR) operate very efficiently without centralised SLB facilities.

Given that authorised CSDs already have the possibility, but not the obligation to offer SLB services under Section B of the Annex of the Level 1 CSD Regulation (“organising a securities lending mechanism, as agent among participants of a securities settlement system”), **there is no need for technical standards to cover SLB services of CSDs.** SLB services are just another part of the toolkit available to CSDs to use when deemed appropriate.

**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.**

*(a) A single European template for CSD reports on settlement fails*

We believe that **a truly harmonised methodology should be used by all EU CSDs for reporting on settlement fails to their regulators.** A harmonised methodology is indispensable to allow for comparability across markets, and for a meaningful aggregation of settlement fails data at EU level. This methodology should be included in the CSD-R technical standards and should be based

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on the existing ECSDA methodology of February 2010<sup>4</sup>, although more granular criteria need to be added (e.g. allowing for the distinction between domestic and cross-border settlements). The current “template” used by ESMA for collecting reports from national regulators also constitutes a workable basis for the harmonised fails reporting requirements, but will require some clarifications and improvements.

For example, we think that it would be more efficient for ESMA to collect absolute number on the volume and value of fails, rather than percentages. National regulators and/or ESMA will easily be able to calculate percentages based on the figures provided, and such an approach would ensure consistency.

Moreover, Clearstream understands that EU regulators would like to be able to compare the level of settlement fails across asset classes, and at domestic and cross-border level, to be able to develop specific recommendations for specific types of transactions. We note that article 69(1)(a) also requires ESMA to report annually on settlement efficiency, including a distinction between “*domestic and cross-border operations for each Member State*”.

We think that the main challenge of the harmonised EU methodology for reporting settlement fails will be to find a workable definition of:

- The different asset class or transaction types;
- Domestic versus cross-border (or internal versus cross-systems?) settlements.

Generally speaking, Clearstream is in favour of a harmonised template to be used by all CSDs for reporting fails to their regulators on a monthly basis. Whereas regulators will always have the possibility to request additional details on an ad hoc basis, we believe that the CSD-R technical standards should be seen as an opportunity to harmonise the reporting standards across all EU markets, thereby facilitating the aggregation of fails data at European level.

#### ***(b) Fails data on different asset classes***

**On the distinction between asset classes**, there is no universal and readily available classification of existing financial instruments that could be used as such for the purpose of settlement fails reporting. Whereas creating a common taxonomy of financial instruments, which each ISIN code being assigned to a specific category, is an overambitious aim, the use of broadly defined categories has at least the merit of avoiding that CSDs each provide their own groupings of financial instruments and would ensure a sufficient degree of comparability, notwithstanding the possibility that the same (type of) instrument might occasionally fall in a different category depending on the interpretation made by the reporting CSDs or their competent authorities.

**We thus recommend that ESMA should broadly define up to 5 categories of instruments for the purpose of settlement fails reporting, allowing each CSD to collect fails data per asset type without that this require technical changes or major investments in CSD’s own reporting systems.**

<sup>4</sup> See [http://www.ecsda.eu/uploads/tx\\_doclibrary/2010\\_02\\_28\\_ECSDA\\_Statistical\\_Exercise\\_01.pdf](http://www.ecsda.eu/uploads/tx_doclibrary/2010_02_28_ECSDA_Statistical_Exercise_01.pdf)

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For example, the following categories of asset classes could be used, based on international standard's classification<sup>5</sup>:

- Equities ("E" category in international standards, except category EU on investment fund units);
- Investment fund units ("EU" category);
- Debt instruments ("D" category except category DY on money market instruments);
- Money market instruments ("DY" category);
- All other securities.

The five categories above will largely suffice, and in any case the total number of categories to be reported for settlement fails purpose, to be manageable, should not exceed 5.

In case ECSDA's proposed categories would be adopted by ESMA, we note that CSDs will have to make adaptations to their current systems as such distinction is not currently used for the purpose of settlement fails reporting. For CSDs not acting as national numbering agencies (NNAs) in particular, solutions will have to be found to acquire the data necessary to the proper categorisation of financial instruments.

*(c) "Domestic" and "cross-border" fails*

**On the distinction between domestic and cross-border transactions**, Clearstream notes that there are different definitions of the terms, not all of which are practical from the CSDs' perspective. In fact, from the point of view of a CSD, it is only possible to distinguish between:

- "internal settlements", i.e. settlement between two participants of that CSD, and
- "external settlements", i.e. settlement between a participant of that CSD and the participant of another, linked CSD, whereas the account of the investor CSD is credited/debited by the Issuer CSD.

In practice, external, i.e. cross-system settlements will often (but not always) be cross-border settlements. An "internal" settlement within a CSD is in its turn typically considered as "domestic", but it could very well be that the underlying investors in the securities are from different countries than that where the securities were issued and settled. Furthermore, in the case of indirect links whereby an investor CSD holds securities at an issuer CSD via the account of an intermediary (considered as a 'domestic' CSD participant by the issuer CSD), transactions will appear as "internal settlements", given that there is no direct link between the two CSDs. In such cases, and provided that the information is available to the issuer CSD, ESMA should clarify whether and how it expects the CSD to report such transactions.

Defining a domestic or cross-border transaction based on the domicile of the investor (as was done in the 2011 Oxera study<sup>6</sup>, for example), would in practice be impossible to implement since CSDs often do not have any information on the identity, let alone on the domicile, of the underlying

<sup>5</sup> See <http://www.anna-web.org/index.php/home/cfiaiso10962>

<sup>6</sup> In the Oxera Study of May 2011 published by the European Commission DG MARKT, a 'domestic' transaction was defined as one where the domicile of the investor and the domicile of the security are the same, and a cross-border transaction as one where the domicile of the investor is different from that of the security. See: [http://ec.europa.eu/internal\\_market/financial-markets/docs/clearing/2011\\_oxera\\_study\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/clearing/2011_oxera_study_en.pdf)

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investors in the securities. Moreover, the domicile of CSD participant's final beneficiary, where it is known to the CSD, is not relevant for the purpose of identifying whether a securities delivery is truly non-domestic, since the underlying investor in securities might be from a country different from the one where the securities were issued and settled.

**As a result, Clearstream recommends that ESMA should require CSDs to report fails data on "internal" settlements and on "external settlements" (e.g. deliveries made via a link) separately.** Given the fact that links are primarily used in the context of cross-border settlements, such reporting would allow ESMA and the EU Commission to assess the level of settlement efficiency in a cross-border context.

***(d) Information on the failing participants***

On the identity of the failing participants, we believe that:

- Regulators should receive fails data at the aggregate level (all participants) by default;
- Regulators should have the possibility to request details about the level of fails of an individual participant of an ad hoc basis, e.g. in case of specific concerns with certain actors in the market;
- Systematically providing details on the identity of the failing participant for each failed instruction would result in lengthy, complex and unnecessarily burdensome reports to regulators;
- Even in cases where the regulator receives information on the settlement performance of an individual participant, the regulator will often not know who is behind the fail (e.g. among the many underlying clients of a given CSD participant) and will need to obtain further information from the market participant in question. CSDs themselves often cannot identify the original failing party, e.g. when omnibus accounts are used.

***(e) Format of the settlement fails reports sent to regulators***

Clearstream supports the use of a machine-readable format, such as Excel or XML. We believe that such formats will allow ESMA to more easily aggregate the reports received from national regulators.

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

CSD-R technical standards implementing article 6(3) should already require CSDs to give participants access to the status of their pending instructions (i.e. whether these are matched or unmatched). This information aims at preventing / managing fails.

Under article 7(1), the information communicated by the CSD to its participants refers to settlement fails information *ex post*, allowing participants to monitor the evolution in their level of settlement efficiency over time. The idea is that CSD participants should be able to access information on their own level of settlement fails. Such information can typically be obtained by CSD participants in one of two ways:

- By accessing their own fail reports in the CSD graphical user interface (GUI);

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- By receiving regular (typically monthly) reports from the CSD on their level of settlement fails as deliverer.

We believe that some flexibility should be maintained as to how participants can access information on their own level of settlement performance. **CSD-R technical standards could for instance require that CSDs provide monthly reports to their participants on their level of settlement fails**, but they should not specify the details of such reports (which will depend on user requirements). Today, CSDs provide fail information to their participant in their capacity as “deliverer”, but not always as “receiver”. In the future we agree that **a participant should be able to view its fails data both as deliverer and as receiver of securities, but such information should not necessarily have to be included in the monthly reports sent by the CSD to its participants if it can be obtained by using the CSD’s graphical user interface (GUI).**

Moreover, a participant should be able to obtain historical fails data for its accounts at the CSD upon request.

In all cases, it should be possible for the CSD to charge a reasonable fee to cover the cost of producing and sending fails reporting to participants.

As well as reporting to regulatory authorities, it will also be beneficial for certain information to be made public, in order for market participants and other interested parties to gain an overall understanding of the settlement landscape. This is provided for in article 7(1) CSD-R, in aggregate and anonymised form on an annual basis, including the measures envisaged by CSDs and their participants to improve settlement efficiency.

**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 believe that there would be value in technical standards defining a “minimum European template” to be used by CSDs for disclosing settlement fails data to the general public.** This annual data should be aggregated to the level of all the CSDs’ participants and include the following information:

- Total value of instructions settled by the CSD
- % of fails based on value over the past year
- Total volume of instructions settled by the CSD
- % of fails based on volume over the year.

The data should ideally contain figures for the past year and the previous year at a minimum, to allow for a comparison of the level of settlement efficiency over time.

**Unlike in the case of reporting to regulators, for which we believe a single set of data should be used by all CSDs, we believe that for public reports it should be possible for a CSD to include additional information on top of the minimum required, or to update the information more frequently than once a year.** This way, the level of disclosure could be adapted to local market characteristics (e.g. in small and concentrated markets, too granular information might not be appropriate if it allows identifying individual market participants).

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Technical standards could require annual aggregate/anonymised settlement fails data to be made available on a dedicated page on the CSD's public website (not on a website with restricted access to CSD participants) or the public website of the respective competent authority.

**Q12: What would the cost implication for CSDs to report fails to their competent authorities on a daily basis be?**

ESMA should seek to harmonise the frequency of CSDs' reports to their regulator(s) in order to facilitate the aggregation of EU-wide data on a regular basis. Currently, most CSDs report fails to competent authorities on a monthly basis and such frequency thus appears appropriate, notwithstanding the possibility for authorities to request additional data from the CSD on an ad hoc basis.

The monthly reports could however be required to contain daily data.

A daily reporting would clearly be disproportionate and overly burdensome (including for regulators), especially given the generally very high level of settlement efficiency in Europe. The operational and administrative costs for CSDs and national regulators having to process the data would be very substantial. Daily reporting on fails should rather be seen as a crisis management measure, e.g. when there is a problematic increase in the level of settlement fails in a given market.

Based on the monthly reports received from CSDs, regulators could be expected to report back to ESMA with the same – monthly – frequency.

**Q13: CSD-R 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?**

**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?**

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

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

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We believe that CSDs, given their low risk profile, should in principle not be involved in the execution of buy-ins and thus does not comment on the buy-in process, which is primarily the responsibility of CCPs.

That said, in line with our comments on the application of late settlement penalties on illiquid securities, we support a proper calibration of the buy-in procedure to take into account the constraints in relation to the liquidity of securities. In particular, highly illiquid securities should be subject to longer timeframes for delivery to the receiving participant.

**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).**

Clearstream generally agrees with the approach suggested by ESMA in §64 to 66 of the Discussion Paper. However we believe that the suspension of a participant should be considered as an extreme measure. It can only be used as an ultimate solution to a serious problem, and will only be implemented after careful consideration of the circumstances of each case.

First of all, in many cases where a CSD participant fails to deliver securities, the fail is not due to the participant itself but to its underlying client(s). Given that in most cases the CSD can neither identify nor suspend the underlying client with whom it has no direct contractual relationship, suspending the participant will not effectively solve the problem. A less extreme alternative that addresses this constraint is for instance applied in Norway. In case of major problems, VPS, the Norwegian CSD, has the possibility to put a restriction on failing participants that forces them to identify the underlying client(s) that have caused the repeated fails. In practice, it means that the participant can no longer accept settlement instructions from this (these) client(s) if it wishes to remain a participant in the CSD. The suspension of the participant itself is thus the ultimate step in case the participant fails to comply with this condition.

Second, expecting a CSD to suspend a participant repeatedly failing to settle on time would imply that the CSD can trigger the suspension of a participant from all relevant trading venues and CCPs. Since this is not the case, we do not believe that a suspension is a reasonable response to repeated settlement failure and that there are other more efficient ways for the CSD to penalise repeated bad behaviour.

Keeping in mind that the suspension of a participant is a measure to be only considered in extreme scenarios, and in very close consultation with supervisory authorities and the other infrastructures involved, Clearstream acknowledges that ESMA might need to establish a threshold (or a combination of two thresholds, to take into account the value and volume of fails) to help define the notion of a participant failing "*consistently and systematically*". **Based on current experience, we believe that the threshold should in any case not be higher than 75% instructions settled on the intended settlement date (in terms of volume or value), and should be calculated over a sufficiently long period, e.g. 12 months.**

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Most importantly, even if one or more thresholds are included in technical standards, it should be clear that **the suspension of a participant should never be triggered automatically once the thresholds are reached**. Some degree of discretion is needed for the CSD to consult with regulators and assess the possible consequences of a suspension for systemic risk.

**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 out-lined above? If not, please explain what alternative solutions might be used to achieve the same results.**

We have strong reservations about the analysis and the proposals made by ESMA in §68 and 69 of its Discussion Paper. In particular, we do not agree with the statement that CSDs *“need to be able to associate the activity of each clearing member, CCP and participant to a trading venue, to a given securities account”*. In fact, we believe that it is the entity responsible for executing the buy-in (e.g. the CCP) which needs to be able to link a failed settlement instruction to a given counterparty.

As far as buy-ins of CCP-cleared transactions are concerned, the processes currently in place are satisfactory and CCPs are able to access the information they need to effect buy-ins which where relevant are passed on to trading members whether or not they act as clearing members or CSD participants. CCPs obtain the required information either through direct participation in the CSD or through indirect participation via a CSD participant. **A requirement to segregate the accounts of clearing members at CSD level is thus unnecessary, and unlikely in itself to solve the problem of buy-in execution.**

Unlike CCPs, trading venues are typically not participants in CSDs and thus might not have access to as much information on the settlement of transactions as CCPs. That said the Level 1 Regulation requires a trading venue to *“include in its internal rules an obligation for its members and its participants to be subject to the [buy-in] measures referred to in paragraphs 3 to 4a.”* It does not require trading venues to execute buy-ins on behalf of participants that have suffered from a fail, but only to foresee a buy-obligation in its rules. It is thus not entirely clear what kind of settlement information trading venues would need to receive from CSDs for the purpose of complying with CSD-R article 7(7).

Imposing a buy-in obligation in the absence of a CCP raises practical problems, such as “who” is responsible for executing a buy-in. That said, we note that where a CSD receives a transaction feed directly from a trading venue, this allows, amongst other solutions, the CSD to send back to the trading venue the necessary information to manage the buy-in with reference to the trading counterparty even if it appoints a settlement agent; **however, such procedure of applying a buy-in at the trading venue level, would be inappropriate as it ignores the various settlement optimisation mechanisms between either:**

- on-exchange,
- on exchange A to exchange B,
- various separate deals bundled within the same exchange,
- various traders via the same CSD participant, and
- OTC business

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**which take place at the CSD layer, among others.** In this regard, it should be considered that both CSD-R and the revised MiFID establish a regulatory framework facilitating access to transaction feeds. Such feeds will be covered by a contractual agreement between a trading venue and the relevant 'linked' market infrastructures. The information flow to be provided for the purpose of executing buy-ins could be specified in these agreements, if applicable at all.

It is unclear whether requiring a trading member or a clearing member to open a separate account at the CSD, segregated from other trading or clearing members holding securities with the same CSD participant, would solve this problem. The requirement to open such segregated accounts would anyways fall on the market participants, and cannot be imposed on the CSD itself, so it seems that such a requirement would go beyond the scope of the Level 1 mandate in CSD-R article 7.

Finally, a further segregation requirement introduced in Level 2 standards would very likely result in a sharp increase in the number of securities accounts maintained at CSD level, which would be costly and could result in capacity problems at some CSDs. Given the limited use of such accounts for the purpose of enforcing buy-ins, and in view of the implied costs, **we are convinced that CSD-R technical standards should not impose segregation requirements on trading and clearing members.**

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

Yes. The requirements are very broad and mix general volume information, contractual framework aspects and operational and risk management procedures.

One could challenge the need to report every quarter on "static" information such as procedures or contracts, whereas reporting on variable information (e.g. volumes, values, fails) could on the contrary require an increased frequency. We would propose that the static information be reported only once a year, and that variable information be reported on a monthly or quarterly basis.

Providing visibility on settlement activity undertaken outside the books of the SSS will also certainly increase transparency on the volumes of CoBM settlement vs. CeBM settlement, and will facilitate systemic risk management at European level. **Steps should, however, be taken to protect operators' proprietary interest in volume and turnover information insofar as it permits comparisons of commercially-sensitive market share information.**

Overall, the information to be reported should be aligned as much as possible with T2S requirements, processes and procedures to minimize adaptation costs for the overall market. Regarding the reporting of settlement fails, ESMA requirements must replicate those (to be) followed by CSDs to ensure data consistency and comparison. Likewise, definitions such as "financial instruments/products settled" or "type of operations" must leave no room for interpretation and be aligned with the (current) CSD reporting obligations, as otherwise the whole exercise would be of minor use for the regulator.

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Finally, in terms of reporting channels, we would suggest that ESMA considers qualifying a number of third-party providers that could help centralising such data collection, while leveraging the work that has been done for EMIR compliance with the appointment of Trade Repositories.

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CSD authorisation

**Q22: Would you agree that the elements above and included in Annex I are appropriate? If not, please indicate the reasons or provide ESMA with further elements which you find could be included in the draft RTS, and any further details to justify their inclusion.**

Partly. The general 'building blocks' contained in Annex 1 of the ESMA Discussion Paper are generally appropriate, but require CSDs to provide very extensive amounts of information for the authorisation process. Much of which is readily published by the CSDs or in the hands of the competent authority.

To allow for maximum harmonisation within the EU, and to avoid the building of any entry "barriers", the final list resulting from this exercise should not be considered as the 'minimum requirements', but rather the 'exhaustive list of requirements' for CSD authorisation. This terminology change is important to ensure equal conditions of authorisation and competition across the EU markets. National regulators should not be allowed to 'gold-plate' these technical standards by having the possibility to require CSDs to produce or maintain additional requirements to operate CSD activities in their national jurisdiction.

As already mentioned the list is very extensive and some items (e.g.: the composition of the management body and senior management, documentation as to policies) are requested several times or in duplication. This should be aligned to avoid inflation of the application file.

We fully understand the CSD Regulation authorisation process, will be a one-off exercise; however CSDs should be allowed to leverage where appropriate on the extensive information provided as part of their yearly disclosure or self-assessment reports under the CPSS-IOSCO Principles for financial market infrastructures (PFMI) in order to demonstrate compliance. This is in particular relevant for section F of Annex I (prudential requirements). A good possibility to avoid unnecessary duplications and to facilitate the complex authorisation exercise would for instance be for ESMA to provide a full list of possible items but to give some flexibility to the competent authorities to reduce the list if the corresponding information that has already been provided in the context of the PFMI assessments. This should also be the case for information that is publicly available (e.g. on the website of the CSD). In such cases it should be sufficient for the CSD to provide the public link to the relevant document.

In addition, it should be set out clearly which documentation is needed for which authorisation, i.e. whether Section A or B of the Annex and the enumerated services therein to avoid confusion and enable transparency for the requirements. The authorisation list should however take into account that CSDs will most probably not be in a position to comply with all technical standards, in particular as regards settlement discipline, at time of filing the application.

CSDs will require additional time for implementation of the technical standards which will make it impossible to include full documentation when applying. Depending on the timeline for implementation, the list should be adapted in a way to provide for certain elements/items to be

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delivered in due course or only after the implementation deadline for the respective matter has passed.

Moreover, while we would not stress the composition of management board or executive management, the policy section is vague and overshooting. There is most likely not "one" person being responsible for approving and maintaining all policies (Annex I, A2 1) and breaches of policies should not lead to reporting duties to competent authority (take out Annex I, A2, 4). It should be made clear that only the policies and procedures listed in Annex I are to be delivered. The requirements under Annex I A3 do not all refer to entities which could be part of a Group. This needs to be clearly structured and group information is to be limited. Items 5 to 7 are not related to Groups either and should eventually be put elsewhere under a different header.

Finally, we disagree to make the International Financial Reporting Standards (IFRS) mandatory (Annex I, B 1) even if this is the case for the Trade Repositories, which were created from scratch upon the adoption of EMIR.

EMIR and its respective technical standards do not require IFRS for existing CCPs, in this same logic, should not be requested for existing CSD either. This goes by far beyond level-1 text, ESMA's authority and is in conflict with national law.

**Q23: Do you agree that the above mentioned approach is appropriate? If not, please indicate the reasons or provide ESMA with further elements which could be included in the draft ITS.**

Yes, we agree with the approach, however feasibility as to storage of information to be confirmed.

**Q24: Do you see other risks and corresponding mitigating measures? Do CSDs presently have participations in legal persons other than CCPs, TRs and trading venues that should be considered? Would banning CSDs from directly participating in CCPs be advisable, in your view?**

It is clearly in the public interest to limit CSDs' exposures to investment losses of all kinds that could deplete the capital available to absorb losses. However, restricting participation to specific sectors does not seem a particularly useful or efficient means of mitigating those risks.

In general terms, we note that CSDs with banking licenses fall subject to capital adequacy standards relating both to credit exposure and to operating risk. It would be appropriate to exempt such institutions from the restrictions proposed in §97 and 98.

With respect to §97, it could be argued that this provision does little or nothing to protect a CSD from losses. Participations in less or differently regulated sectors may involve less risk than participations in the sectors mentioned.

A better approach would be to define capital adequacy standards in relation to the degree of operating risk that a CSD takes in function of such variables as its settlement turnover, assets in custody and so forth. In considering such an approach, it would be important to remain consistent with the equivalent provisions of CRD IV.

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Even leaving these crucial considerations aside, the restriction would prevent CSDs from participating in ventures which are core to its business functions. Examples which in our view are beyond reasonable debate would include messaging systems, network providers, other CSDs, trade capture and reporting systems, numbering systems, trade associations and so forth.

As an example, the mandatory participations in SWIFT should be listed, for which the percentage of participation will not likely reach 10 % in any case, it nevertheless is an element to be addressed.

Additionally for participations in CCPs we do not recommend to ban those. Most likely no CSD will do such participation as the underlying capital requirements for the CSD would most likely already stop them from investing. This however cannot be excluded on a group level having both a CSD and a CCP under same ownership. Furthermore, as there are some benefits of common ownership, capital restrictions under CSD-R article 46 should be sufficient to regulate this without an explicit ban.

**Q25: Do you consider the approach outlined above adequate, in particular as regards the scope and frequency of information provision and the prompt communication of material changes? If not, please indicate the reasons, an appropriate alternative and the associated costs.**

No, the proposed approach is adding an overly formal and burdensome annual review procedure which should be avoided.

While we fully support ESMA's statement in §100 that "authorities should, in a post-crisis context, increase their capabilities of ongoing supervision rather than over-relying on ad-hoc supervision". We also note that CSDs will be required under CSD-R article 16 §3 to "inform competent authorities without undue delay of any material changes affecting the conditions for authorisation". Technical standards should thus acknowledge that there is already an efficient ongoing supervisory regime in place, which does not require additional extensive ad-hoc reviews. An overly formal and burdensome additional annual review procedure should thus be avoided. In order to keep the review procedure as efficient as possible, for the CSD as well as for the competent authority, it is important to avoid the duplication of information and to make efficient use of the information already provided by the CSD and thus already available to the competent authority. The review exercise should thus rely as much as possible on information already provided by the CSD and only require CSDs to provide additional information where those are not yet available to the competent authority. CSDs should for instance not be required to prepare extensive additional reports summarising information that was already sent to the competent authority.

The review exercise should also leverage as much as possible on CSDs yearly self-assessments and disclosure against CPSS-IOSCO PFMLs, which already cover most of the information required for the review.

Equally important as duplications between CSD-R reporting and reporting in the framework of CPSS-IOSCO PFMLs, is to avoid duplications over time. As ESMA rightly points out in §102 of the discussion paper, all relevant information for the review is also included in the information in

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relation to the application for CSD authorisation. It should be sufficient for the CSD to communicate to the regulator any relevant updates of this information.

With regards to the strategy changes, these are hard to determine, and hence it should be clarified from which point in time CSDs should have to disclose such material changes to their strategy.

Focusing on relevant updates only would also considerably facilitate the work for competent authorities and thus contribute to the efficiency of the supervision process. We support ESMA's intention expressed in §104 to focus on the quality of the documentation rather than on the quantity and that "only relevant documents should be provided". This principle should be clearly reflected in the draft technical standards.

We understand that the article 22 review exercise is intended to replace the previous annual ESCB-CESR reviews. The exercise should therefore build as much as possible on existing procedures and practices.

**Q26: Do you agree with this approach? Please elaborate on any alternative approach illustrating the cost and benefits of it.**

Partly. We agree that in general the principle of non-discrimination should apply, however it needs to be born in mind that this kind of treatment will not be given to EU-CSDs when they are active outside of the EU. In other words, while a non-EU CSD would only be under the obligation to fulfil the EU requirements to be recognised, an EU CSD aiming to provide services in that country may be under more severe requirements or even excluded from providing services at all. As a result, EU-CSDs may be subject to competitive disadvantages that may permit non EU-CSDs to offer more competitive pricing and services to EU participants who would be tented to rely then on non EU-CSD's services.

In this context it should be noted that whilst such non-EU CSD would be subject to recognition of ESMA and there would be cooperation with the national regulator, the EU competent and relevant authorities have no means themselves to impose regulatory measures to ensure compliance with the CSD Regulation. An important impact on the safety and efficiency to cross-border settlement could not be immediately dealt with by the EU authorities.

For this reason, additional requirements, such as at least the legal and factual possibility for the EU-CSDs to provide services in the non-EU CSD home-country and the assurance of enforceable regulatory measures for EU authorities should be imposed as a requirement for recognition. Moreover, we also note that the current recognition procedure seems to be designed as a one off exercise, i.e. once a third country CSD is recognised there are no follow-up arrangements/ requirements that ensure ongoing supervisory equivalence. It will have to be considered how this can be turned into a more dynamic approach that ensures continued equivalence.

In line with EMIR technical standards, the CSD-R standards should include a list of all requirements for third country CSDs to apply for recognition.

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**Q27: Do the responsibilities and reporting lines of the different key personnel and the audit methods described above appropriately reflect sound and prudent management of the CSD? Do you think there should be further potential conflicts of interest specified? In which circumstances, if any, taking into account potential conflicts of interest between the members of the user committee and the CSD, it would be appropriate not to share the audit report or its findings with the user committee?**

Yes, responsibilities, reporting lines and audit methods of key personnel appropriately reflect sound and prudent management of the CSD. Having said this, any standards should bear in mind that the responsibilities of the management body as well as conflict of interests rules may already (at least partially) be dealt with by national corporate and regulatory law and/or even EU law (CRD IV- for CSDs holding a banking license). Any conflict with such other law(s) has the potential to create legal uncertainty and any rules should therefore take into account national/EU law that already deals with the same topic.

#### **a) Monitoring tools**

Regarding monitoring tools, we note that CSD-R article 26(1) requires CSDs to “identify, manage, monitor and report the risks to which it is or might be exposed”. The integrated and comprehensive approach to risk that ESMA proposes in §110 would clearly go beyond this by extending the scope from the CSD’s own risks to the risks it poses to participants and other entities. We do not believe that such a step is consistent with ESMA’s level 1 mandate which is limited, as ESMA correctly recognises in §109, to specifying monitoring tools and not to redefine the scope of the risks covered.

In addition, it is not clear how a CSD would be able to “identify, manage, monitor and report” risks in relation to participants’ clients. In our view, it is the responsibility of the respective participant to assess and manage the risks in relation to its clients.

We also note that some flexibility is needed in relation to the requirement to have several dedicated functions (chief risk officer, compliance officer, chief technology officer and independent internal audit). In particular for smaller CSDs, “dedicated” should not be understood as a full-time position for each CSD. The related tasks often do not require full-time positions. It is common for instance that a CSD’s Legal Counsel is also appointed as the company’s Compliance Officer. Similarly, in corporate groups that include several CSDs, a single employee often fulfils the dedicated functions referred to above for several CSDs in the group, and as a Group function. Such an efficient allocation of tasks must remain possible for CSDs. Given the limited number of employees and resources of CSDs in smaller markets, they cannot be expected to increase their workforce significantly just to fulfil the requirements of CSD-R technical standards.

#### **(b) Potential conflicts of interest:**

We would like to point out that the list of potential conflicts of interest proposed by ESMA is very extensive. The mere fact of holding shares in a publicly listed company that is also client of the CSD or acting as a nominee on behalf of customers, for instance, does not automatically entail a conflict of interest. Much will depend on the interpretation of the terms and the related

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requirements. Disproportionate and unnecessary administrative burden should be avoided. Given that CSDs will be legally required to “maintain and operate effective written organisational and administrative arrangements to identify and manage any potential conflicts of interest”, it is important to restrict the interpretation of conflicts of interest. The materiality of each case needs to be considered in order to cover only cases of “real” conflicts of interest.

**(c) Audit methods:**

It is important to clearly distinguish financial audits undertaken by the external auditor from more comprehensive “independent” audits by the internal audit function and to specify the scope of both types of audit. Article 26(6) only states that CSDs shall be “subject to regular and independent audits”.

**In this regard, an important point to take into account is that audit reports are made having the target audience in mind. An internal audit report will be clearly directed to the management, for internal assessment, hence should not be forced to be shared externally including with the user committee. In case such reports would be shared, which include real incidents, possible weaknesses etc. this might trigger client claims which would not see the day otherwise.**

**We therefore strongly oppose to share internal audit reports as well as the external auditor’s report with the user committee, summary unqualified or qualified audit opinions which are drafted for an external audience, would be the only documents which are and should effectively be shared.**

In general, it should be ensured that competent authorities have sufficient leeway to interpret the related requirement in a proportional way. A proportional approach is extremely important given that strict audits requirements would result in very substantial costs for the CSD that need to be clearly justified. A mandatory external audit of the internal (independent and separate) audit function as proposed by ESMA (§121) is, for instance, in many cases clearly disproportionate.

In this regard, we also note that question 27 of the discussion paper seems to invert the logic of the CSD-R level 1 text by asking for cases where the sharing of audit results with the user committee would not be appropriate. The underlying assumption being that by default it is appropriate for CSDs to share these results with the user committee, whereas level 1 text mandates ESMA to specify the “circumstances in which it would be appropriate (...) to share audit findings with the user committee”. In this regard, we strongly oppose to share internal audit reports as well as the external auditor’s report with the user committee. Only summary unqualified or qualified audit opinion would be the right documents to be shared, to avoid exposing the CSD to possible client claims which would not have come into effect otherwise.

When specifying CSD-R audit requirements, ESMA should also take into account that CSDs with banking licence are already subject to audit requirements under CRD IV. Duplications and inconsistencies between both sets of requirements should be avoided.

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**Q28: Do you agree with this minimum requirements approach? In case of disagreement, what kind of categories or what precise records listed in Annex III would you delete/add?**

No, Clearstream cannot agree to the “minimum” requirements as described above since this would turn the CSDs from a securities settlement system into a data-warehouse, function which is not foreseen in the context of the Level 1 text of the CSD-R.

The ESMA discussion paper departs from the premise that CSDs have a full overview of the entire securities transaction chain. This perspective is not fully accurate, as some information and data might not be currently communicated to the CSDs by its users.

The technical standards aim should be promote CSD’s stability throughout the EU, however the proposed **technical standards for recordkeeping go beyond this goal. ESMA should weight the costs these technical standards will imply to CSDs in relation to the stability benefits they may provide before imposing them.**

The proposed requirements would require a complete reorganisation of data-keeping (databases and documents) for Clearstream and potentially also for GDB overall. This follows from the fact that:

- Clearstream (so far) has not all requested data available,
- that the requested data and documents on securities, issuers, customers, business services, penalties etc. – if available – are to a large extend neither “readily accessible” (see details in ESMA DP §122, §123 and 128) or combinable for a third party nor currently stored in one database enabling to view data and documents, and
- it is doubtful whether all these required records are stored for a minimum period of 10 years already (since partially not required by German Law).
- In the DP, ESMA distinguishes between four different categories of records in relation to core and ancillary services etc. with specific recordkeeping requirements (**Annex III**) to be kept by a CSD and to be readily accessible for the competent authorities:

#### Contents of the recordkeeping requirements

First, the list of items in Annex III of the Discussion Paper is very extensive and goes beyond what is required by regulators today. In fact, based on our understanding of ESMA’s current proposal, the quantity of data to be stored over (a minimum of) 10 years and related functionalities would result in potentially huge IT costs, potentially requiring CSDs to build an entirely new IT system, or at least to substantially overhaul their existing systems. Indeed some of the proposed technical requirements, such as online inquiry possibility, the possibility to re-establish operational processing, query function through numerous search keys, and direct data feeds, are much more demanding than current CSD recordkeeping practices. Adapting to these requirements would require a combined investment of tens of millions for CSDs in Europe. Introduce more detailed cost estimates based on members’ responses.

Moreover, for CSDs participating in T2S in particular, having to develop a parallel system outside T2S will create a lot of complexity while negatively impacting the cost efficiencies generated by the use of a single, centralised platform for all T2S markets. We thus believe that the requirements

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being proposed by ESMA are disproportionate, and go beyond what is required for effective supervision.

Most importantly, we believe that the purpose of recordkeeping requirements, as specified in CSD-R article 29, is to allow supervisory authorities to ensure “compliance [of the CSD] with the requirements under this Regulation.” The objective is not and should not be to:

- Use CSDs as trade repositories, to retrieve market data at individual transaction/instruction level, and obtain details on activities of individual CSD clients;
- Use these records as a way to ‘recover’ CSD activities in case of financial or operational failures.

Recordkeeping should thus be understood in the light of supervisors’ assessment of CSDs’ compliance with the CSD Regulation, and should be distinct from considerations on trade repository services or recovery and resolution plans. For CSDs, recordkeeping is essentially about data retention and archiving in order to be able reply to inquiries by competent authorities.

In particular, as we are not aware of any specific problems or complaints by regulators as regards the current level of detail of the records stored by CSDs. The rationale behind the far-reaching requirements being proposed by ESMA is thus difficult to understand, and see very limited added value in keeping an unnecessarily heavy amount of data, especially given the burden it will impose on regulators themselves, when making use of the data.

As a result, we believe that the list of records contained in Annex III of the Discussion Paper should be significantly shortened. Many of the items in the proposed list generally do not seem relevant for the purpose of ensuring compliance with the CSD Regulation. At a minimum, the following items should be removed from the list:

- SR3 Persons exercising control on Issuers
- SR13 Persons exercising control on Participants
- SR14 Country of establishment of persons exercising control on Participants
- FR3 Client of the delivering participant, where applicable
- FR9 Client of the receiving participant, where applicable

CSDs typically do not have access to such information and it is unclear how such records would contribute to evidence CSD’s compliance with CSD-R requirements.

Clearstream should also acknowledge that some records will be linked to the provision of a given service, and that CSDs not offering the service should thus not be expected to keep the relevant records. In this context, we welcome the more flexible approach adopted by ESMA on records in relation to ancillary services (§126). But we would like to recall that the definition of a CSD in CSD-R article 2 does not require CSDs to provide all three core services, but only two out of the three. Hence, recordkeeping requirements will need to take this into consideration. Actual data available to the CSD will depend on its service offering and the data required for its operational processes. The recordkeeping requirements will thus have to be adapted depending on the individual services provided by a given CSD based on the list of services contained in section A, B and C of the Annex in the CSD Regulation.

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More generally, we do not think that a “minimum requirements” approach is appropriate as it could result in some national regulators ‘gold-plating’ the ESMA list and adding additional requirements, thereby introducing distortions among CSDs. Instead, ESMA should follow a “maximum requirements” approach, providing a harmonised list of records while giving some flexibility to competent authorities not to require records that are not relevant for the particular CSD.

That said, we recognise that there will be cases where a need is identified for regulators to have access to certain information that is not part of regular recordkeeping. In such cases, competent authorities should retain the possibility to request CSDs to keep and provide such information, but such requests will typically have a different justification and other purposes than assessing the CSD Regulation compliance.

Regarding point iii) under §128 of the Discussion paper stating that “it is not possible for the records to be manipulated or altered”, we suggest that ESMA should clarify that the prohibition to alter records applies to transaction data. For other records and static data, it should be possible for the CSD to make changes, albeit with a strict track record of the amendments made.

#### Format of the records

As regards the format of the records to be stored, we think it is not necessary (and indeed sometimes not possible) to require CSDs to maintain records online (immediately available) but that it should be sufficient to store the data offline as long as this data can be retrieved within a few days. This is a much more practical approach, considering the high amount of data involved.

We would also cautions against imposing the use of open, non-proprietary standards for recordkeeping purposes. Such a requirement would entail huge costs and would require significant changes to CSDs’ system. Instead, ESMA should allow CSDs to maintain records in a proprietary format wherever this format can be converted without undue delay into an open format that is accessible to regulators.

#### Timing of implementation

Depending on the final recordkeeping requirements to be included in the CSD-R technical standards, CSDs might have to make considerable investments to build and maintain the relevant IT systems, and such developments are likely to months to implement. This could mean that it will be close to impossible for most CSDs to comply with the recordkeeping requirements by the time they apply for authorisation under the CSD Regulation. ESMA should consider such a constraint and determine an appropriate transition period to allow CSDs to develop the required functionalities.

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**Q29: What are your views on modality for maintaining and making available such records? How does it impact the current costs of record keeping, in particular with reference to the use of the LEI?**

Direct data feeds for regulators

We do not believe that technical standards should require CSDs to build and maintain direct data feeds for their competent authorities, and we wonder whether such a measure might not exceed the mandate granted to ESMA under the Level 1 Regulation. In addition to the cost considerations, it is questionable whether regulators will truly make use of such data feeds, and it is far from certain that such type of data exchange would present significant advantages compared to a situation where CSDs provide data promptly to regulators upon request. The use of direct data feeds is currently limited to a few countries and experience suggests that regulators tend to continue to rely on ad hoc requests for information to the CSD, even when they can access the data directly, because the latter is often more convenient.

Use of LEIs

We do not believe that CSDs should be required to use global Legal Entity Identifiers (LEI) in their records. Such identifiers are not currently in use at CSD level, and their implementation has been limited so far to OTC derivatives markets, where CSDs are typically not involved. Imposing the use of LEIs for the purpose of recordkeeping is unlikely to bring any substantial benefits. As mentioned earlier, CSD recordkeeping requirements should not result in regulators transforming CSDs into trade repositories.

The LEI is currently in the process of being approved in many world-wide jurisdictions and there will be countries in which the LEI will not be adopted it, hence a mandatory use outside the EU (or G20 countries in general) might not be possible.

Imposing the compulsory use of LEI would also require costly changes to current CSD systems and would also increase costs for CSD participants (who would subsequently be required to adapt their systems as well) and ultimately to the investors themselves. Such a requirement would also exceed the Level 1 mandate under CSD-R article 29.

It is one thing to be asked to add the LEI to our records going forward, but it would be impossible to add this information to our historic records.

Without denying the benefits linked to the use of LEIs in terms of harmonisation, we believe that the CSD-R technical standards on recordkeeping are clearly not the right place to promote their use. More analysis is needed, and a gradual implementation of LEIs outside derivatives markets should be coordinated at global level, rather than imposed on EU CSDs only via binding regulation.

**Q30: Do you agree that the CSD risk analysis performed in order to justify a refusal should include at least the assessment of legal, financial and operational risks? Do you see any other areas of risk that should be required? If so, please provide examples.**

Yes, however besides the three risk groups that have been listed in the discussion paper, it is our opinion that "Compliance Risk" should be considered as an additional separate risk category.

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Particularly, an assessment resulting in the failure of the applicant to demonstrate continued compliance with AML requirements, UN, EU or third country sanctions programmes, terrorist financing according to the CSD's standards, should be considered legitimate grounds for refusal.

In addition to these features, the admission process and the CSD's eligibility policy should place a burden of proof on the applicant to demonstrate that it is in a position to protect the CSD from the risk of a violation of money laundering, terrorist financing, market abuse and applicable sanction provisions. The applicant must be able to demonstrate that it has both the policies, compliance frameworks and the tools to discharge this duty effectively.

It is in our view insufficient to rely on the fact that an applicant is regulated or even "equivalently" regulated since the CSD itself remains solely responsible for client due diligence and KYC (Know Your Customer) standards.

Consideration should be given to whether CSDs should be required to undertake enhanced due diligence for participants operating client accounts on an omnibus basis. In such cases, the CSD will not necessarily know or have reason to know the identity of the principals to a transaction or to a holding and is therefore especially exposed to the effectiveness of the compliance framework of its participant.

We once again point out that provision §138 conflicts with the provision of the Money Laundering Directive. Where an applicant is refused because it is considered to be potentially involved in money laundering, terrorist financing, market abuse, or sanctions violations it may be a criminal offence to provide an "adequate explanation with a level of detail that allows for understanding the risks related with the provision of services" for the refusal of service. In such cases, CSDs should not fall under a regulatory expectation to violate public order provisions.

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

No, we believe that these standards would benefit from a far fuller consultation with enforcement agencies to address the scenario that an applicant is refused access because it has failed to satisfy the Client Due Diligence and KYC standards of the CSD. It is neither reasonable nor proportionate for the regulatory authority to put itself in a position to force a CSD that it supervises to breach the standards of its compliance frameworks by requiring it to provide access to the requesting party. Whilst it may be argued that ESMA would wish to respect the terms of a CSD's compliance framework, the interpretative burden that this imposes should not be underestimated. For example, third countries apply sanctions regimes extra-territorially and a CSD must therefore assess – often on the basis of unclear and untested legal assessments – the degree to which it is exposed to a risk of violation. It is also not self-evidently the case that compulsion by ESMA would constitute a sufficient mitigation in the case that enforcement actions were taken against the CSD.

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

No, considering that through its constant monitoring and reconciliation of issued nominal amount (including validation on issues for up-to amounts), shares or units of certificated securities with total amount of respective book-entry credits in the central holding and settlement system, and including reconciliation of vaults vs entries in settlement system for physical securities, Clearstream ensures the integrity of the issue, an additional internal reconciliation process for corporate actions processing is of no added value and does as such as well not reduce risks related to corporate actions processing. Considering the level of integrated controls to secure the integrity of the issue, no additional analysis on costs and benefits on an additional internal reconciliation process for corporate actions processing has been performed.

What is essential for corporate actions processing, is that the external reconciliation has been performed and in case of reconciliation break, the difference is to be investigated and solved urgently, in order to have the same baseline for starting the corporate actions processing.

This pre-corporate action processing reconciliation is covered with the regular, daily reconciliation process that Clearstream performs for all its securities holdings and the respective agents and depositories. The resulting proceeds from corporate actions are reconciled as well before being distributed to the entitled account holders.

**Q33: Do you identify other reconciliation measures that a CSD should take to ensure the integrity of an issue (including as regards corporate actions) and that should be considered? If so, please specify which and add cost/benefit considerations.**

No, the measures described are sufficient.

An additional internal reconciliation measure regarding the control measures could be considered for the daily monitoring and follow up of internal accounts to ensure that no interim credits have been performed on internal accounts. This control process is covered in Clearstream in the context of the Vaults Safekeeping controls process.

**Q34: Do you agree with the approach outlined in these two sections? In your opinion, does the use of the double-entry accounting principle give a sufficiently robust basis for avoiding securities overdrafts, debit balances and securities creation, or should the standard also specify other measures?**

Yes, we fully agree that a credit on a receiving account should always be linked to a corresponding debit on the delivering account. This is the appropriate way to avoid an "inflation" of securities.

Moreover, the double-entry accounting principle is generally sufficient to avoid overdrafts, debit balances etc. An additional level of safety could derive from the legal nature of the securities book-

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entry credit: In case the said credit as well as transfers of these book-entry credits are based on rights *in rem* (e.g. in Germany) an overdraft, back valuations of securities credits etc. would legally not be possible. Violations of that rule ("no negative thing") could lead to rectifying claims/ measures and/or damage claims.

**Q35: Is the above definition sufficient or should the standard contain a further specification of operational risk?**

It sounds reasonable to follow the definition under CPSS-IOSCO PFMI 17 to avoid a diverging or conflicting definition.

With regard to the methods of assessment mentioned under §151 above, we suggest to follow the *CPSS-IOSCO* PFMI Assessment Methodology.

**Q36: The above proposed risk management framework for operational risk considers the existing CSDs tools and the latest regulatory views. What additional requirements or details do you propose a risk management system for operational risk to include and why? As always do include cost considerations.**

Most important will be to ensure that technical standards on operational risk are in line with the detailed CPSS-IOSCO requirements on this topic. In order to ensure consistency with global standards the PFMI should therefore be the basis for all requirements. We note that most of the requirements proposed by ESMA are indeed in line with the PFMI. However, the following issues require in our view some clarification:

- ESMA suggests in §154 that CSDs should have a "robust operational risk-management framework with appropriate IT systems, policies, procedures and controls". This should not be understood as a requirement for CSDs to use special IT tools for operational risk-management. Even where such tools exist, they are not commonly used by CSDs and given the well-established practices and tools in place, there is no need to impose such a change by law. This would be linked to substantial costs, for a very uncertain result and probably even a likely negative impact on the efficiency of operational risk management.

- §157: Depending again on the interpretation, a central function for managing operational risk with the extensive list of tasks proposed by ESMA is probably not necessary at least for some (smaller) CSDs and would impose a disproportionate burden on them (and market participants who would ultimately need to pay for the resulting costs).

- §160: We agree that CSDs should have appropriate procedures in place to record, report, analyse and resolve operational incidents. This should however be limited to "all material operational incidents" in order to ensure proportionality. These procedures should not be required for insignificant incidents that do not affect in any way the efficient functioning of the CSD's system.

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- §161: In line with our comments above, the review of operational risk management processes by internal audits is more appropriate. This paragraph should thus not refer to external audits. On this point, we suggest that ESMA should also take into account ongoing discussions within T2S on the review of operational risk management processes.

Finally, the Operational Risk Management Framework should also include and explicitly mention the business impact analysis and scenario based risk analysis which is at the moment only mentioned under the Business Continuity Policy §168 and 169 (Q39).

**Q37: In your opinion, does the above proposal give a sufficiently robust basis for risk identification and risk mitigation, or should the standard also specify other measures? Which and with what associated costs?**

Yes, no further measures are necessary.

**Q38: What are your views on the possible requirements for IT systems described above and the potential costs involved for implementing such requirements?**

We note that a mandatory (at least) yearly review of IT systems and IT security framework (§167) is beyond current practice, also given the complexity of such an exercise.

On point 165 §2 - Our approach to capacity planning is totally different to what would be required by these draft requirements. The draft would require us to have a "demand forecast model" that would allow us to plan future capacity and the scale up accordingly. This would require volume prediction information we are unable to obtain. As a result we maintain sufficient "headroom" on our capacity to handle the historic peaks of processing load we have seen.

On point 165 §4 - We think that the information security framework should be a risk based framework. A risk-based Information Security Management System (ISMS) should be implemented to ensure the continuous improvement of controls and/or that new controls are evaluated. The basis for a cost-effective risk decision is an information classification of all relevant information taking the potential business impact into account. The combination of likelihood that a potential weakness could be used results in a risk the CSD needs to decide on, where high risks should be closed or mitigated and low risks might be accepted.

Current technologies and changes to business processes need to be part of this process. Important issues with technologies should trigger and ad hoc reviews of the potential risks and seek a timely risk decision. Secondly regarding the bullet points included therein, we suggest to only define domains to be covered by the Information Security Framework/ISMS.

On point 166 regarding outsourcing – Normally for those CSDs being part of a group, the legal entities of the CSD might outsource their processing and parts/all of their operations to other legal entities within the same Group. Therefore besides what is already applicable for IT outsourcing in Germany and Luxembourg (for example MaRisk in Germany and in Luxembourg by the Decree Grand-Ducal of 13 July 2007 and CSSF circulars 12/552 as amended), we believe the proposed

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draft requirements are inappropriate for outsourcing arrangements within the same Group of companies.

On point 167 – ESMA proposal requests for "the information technology systems (...) should be reviewed, at a minimum, on an annual basis". The yearly review requirement would be rather high target to achieve. At present Internal Audit conducts a multi-year cycle of audits based upon a risk assessment of each application. Some applications would be covered annually but many other would not. External auditors also perform some audits for their normal work, and these are reported in the Long Form report, but again not all systems are covered each year. A cyclical review to be agreed with the competent authority of all processes in a sequential order would be a more appropriate way to address this requirement duly.

**Q39: What elements should be taken into account when considering the adequacy of re-resources, capabilities, functionalities and staffing arrangements of the secondary pro-cessing site and a geographic risk profile distinct from that of the primary site?**

The requirements on the secondary processing site are good examples for the importance of a proportional and targeted approach. The meaning of a "geographically distinct risk profile" will for instance crucially depend on local conditions and cannot be defined in an overly prescriptive way (for instance specifying an exact minimum distance for small countries like Luxembourg, this is a very relevant issue, etc.). The focus should be on risks, in particular the likelihood of natural disasters etc.

Considerations require knowledge of the local geographic and market conditions, technical standards should leave some room for local regulators to apply the requirements appropriately.

Technical standards should provide for the possibility for CSDs to set up their second processing site in a Member State different from their home member state. Such a possibility is of course only relevant in a very limited number of cases today, for instance for CSDs that are part of a group that includes other CSDs and similar markets but could become more important with increasing integration of EU financial markets and should thus not be prevented by law.

Resources, capabilities, functionalities and staffing arrangements should ensure that the identified critical functions can be maintained and recovered within the stated recovery time objective. It should be considered that processing sites can often be operated remotely by staff in another location.

A distinct risk profile between the primary and secondary processing sites depends on the geographical setting, region, country or location. For example, certain regions are exposed to hurricanes, earthquakes, etc. and others are not at all. Therefore a minimum distance should or cannot be expressed in numbers of kilometres, as a rather small distance in one region may ensure a distinct risk profile and in another region it may not. The minimum distance between primary and secondary sites should ensure that both sites are not sharing single points of failure (e.g. common infrastructure, such as power grid or telecommunications) and that the same physical event (e.g. natural disaster) does not affect both sites.

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We would also like to stress that in case that CSD-R technical standards would require some CSDs to change their policy regarding the secondary processing site, they need to be given a sufficient time to implement such changes. This is important given that the process to set up a new secondary processing site is complex and requires significant resources both financially and operationally.

Comments on the text:

“Business continuity policy” and “disaster recovery plan”: the two terms are used in a confusing way, either together or independently in the text. A clear distinction should be made between policy and plan, in terms of content. A policy typically does not contain implementation or operational details. A plan does. The paper is not clear in this respect, respectively suggests that the policy should include information which is normally in the plan. Such as the identification of critical functions and systems, that is normally either in the plan, in the risk analysis or impact analysis. The text could state that the policy “requires” identification of critical functions, etc. which would be much clearer.

“In extreme scenarios”, “large scale disasters”, “in all circumstances”: please provide a definition or guidance on the scope which underlies these terms. There might be circumstances not under the control of the CSD, especially in “extreme” or “large scale” scenarios, which could perhaps lead to a protracted recovery time, without questioning the stated recovery time objective as such. Examples could be scenarios of cyber-attacks or other leading to data corruption in both processing sites.

The business impact analysis and scenario based risk analysis mentioned under §168 and 169 are by nature part of the Operational Risk Management Framework and should therefore be explicitly mentioned under that section (Q36).

§171: “the participation of customers, external providers and relevant institutions”. CSDs can invite external parties to participate, but have limited means to oblige those parties, unless this could be contractually agreed or enforced by regulation. However, often such parties are not subject to regulations of CSDs. It would appear to be more practical, efficient and effective, if for example industry-wide tests would be organized by regulators or a market association, as it happens in some jurisdictions.

On the maximum recovery time of 2 hours is fine in general. However, depending on time during the day, this recovery time might not be needed. Therefore some flexibility in the sense of:

- 2 hours for critical functions in general
- A longer recovery time acceptable in case no critical deadlines will be delayed by more than 2 hours

**Q40: In your opinion, will these requirements for CSDs be a good basis for identifying, monitoring and managing the risks that key participants, utility providers and other FMIs pose to the operations of the CSDs? Would you consider other requirements? Which and why?**

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With regard to utility and critical service providers which the CSD is dependent on, the problem is that the CSD cannot always enforce requirements in particular in one-of-one situations, be it for example telecom providers, central banks, payment systems (such as Target2) or T2S in the near future. Further, the CSD's regulator may not be the service provider's regulator and therefore the question would be what the CSD's regulator will do with the information about the service provider reported to it by the CSD.

In the case of financial instruments, clarification is required, if collateral obtained in reverse Repo transactions whether this falls under "financial instruments" definition.

Regarding instruments that have a duration greater than ten years until maturity, we note that Markets consider instruments with a maturity up to ten years as highly liquid.

Regarding point 176, extensive and periodic due diligence process covers most of these requirements. However for the maintaining of level-playing field, the detail that this point suggests should be kept in line with the CPSS-IOSCO requirements on links, as some of the FMI's we connect to could be located outside the EU. In addition, ESMA standards should also considered that links are often established between competing CSDs, and in this same logic there are limits to the detail of information which could be shared between competitors remains a delicate subject which should be weighted in this requirement.

We also question the concept behind the point as well, as it implies that CSDs have the obligation to manage the risks being run by all those we are connected to, hence insourcing their risk management. Such a requirement should lead CSDs to understand the impact of their failure and have contingency plans in place to mitigate any failures in the context of links.

**Q41: Do you agree with the approach outlined above? In particular, do you agree with the approach of not distinguishing between CSDs that do not provide banking services and CSDs that do so?**

No, CSDs that provide banking services are already subject to stringent regulatory framework. Consequently, the proposed technical standards should only apply to CSDs which are not authorised to provide banking services.

In general terms reference to the Directive 2006/48/EC has been replaced by CRR / CRD IV, ESMA's reference should be updated.

On the average duration of 2 years maximum for debt instruments, this does not seem to be adequate as this would restrict the purchase of government bonds with a reasonable maturity. We would consider 10 years maximum remaining maturity and possibly 5 years average duration maximum. In combination with element (i) "low credit, market, volatility and inflation risk this would seem to be sufficient.

Furthermore, also debt instruments issued by or guaranteed by Regional governments should be considered under similar conditions as those for central governments (e.g. German Länder).

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We are clearly opposing the prohibition of hedging. While we agree to prohibit proprietary trading in its narrow sense (trading in order to earn short term profits from price movements / differences), we clearly need to be in a position to hedge interest rate and currency risk. Furthermore, it is also necessary to enter into derivatives (e.g. cross currency swaps, deposit swaps) in order to reduce open risk positions and concentration risk. On point 182, we need to clarify that the CSD Regulation should not forbid hedging (a CSD must be allowed to hedge its market risk exposure), but to forbid considering this hedge instrument as "highly liquid asset". In this context we would suggest to amend §182 as follows:

*182. Moreover, ESMA considers that CSDs should only invest in assets where disinvestment is possible easily in times of need. CSDs should not be allowed, as principle, to consider their investment in derivatives to hedge their interest rate, currency or other exposures **as highly liquid instrument**. Investment in derivatives would expose the CSD to additional risks which are not typical for the settlement activity.*

For CSDs operating with an additional banking license, concentration limits are regulated under the Large Exposure rules. No additional concentrations rules should be applied. However, as article 46 goes beyond the CRD requirements, we cannot see how we can refer to CRR only for the investment policy. The overall approach of the CSD Regulation to allow banking services was to allow this under strictest conditions.

**Q42: Should ESMA consider other elements to define highly liquid financial instruments, 'prompt access' and concentration limits? If so, which, and why?**

On the definition of "highly liquid" financial instruments proposed by ESMA (§181), we would like to point out that the average duration until maturity of debt instruments has in many cases no influence on the liquidity of the instrument. The liquidity of debt instruments with an average duration of 2 years until maturity is not generally lower than shorter dated instruments. Point (ii) in §181 on debt instruments should therefore be removed.

Moreover, and specifically for CSDs with a banking License, the Central Bank eligibility in combination with the possibility to allow a wider range of instruments for CSD-Banks should be considered.

**Q43: Do you agree that links should be conditioned on the elements mentioned above? Would there be any additional risks that you find should be considered, or a different consideration of the different link types and risks? Please elaborate and present cost and benefit elements supporting your position.**

Yes, the proposed measures make sense and it is legitimate to apply different/more stringent requirements to bespoke links. It is acceptable to treat standard and customised links on an equal basis as risk profiles would normally not differ fundamentally. The risks inherent to the introduction of against payment settlement also justify the adoption of additional requirements.

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Finally, the supplementary conditions applicable to interoperable links are acceptable and reflect what already exists today as far as Clearstream is concerned.

Moreover, among the legal risks to be considered, should be the non-compliance with AML, anti-terrorism financing, sanction regimes, etc.

**Q44: Do you find the procedures mentioned above adequate to monitor and manage the additional risk arising from the use of intermediaries?**

Yes, the proposed requirements are aligned with the contractual terms that are already in use between Clearstream and the sub-custodians used for indirect links. We would however propose that a differentiation is made between indirect links involving a commercial bank and indirect links involving an investor CSD as intermediary. In the latter case (which will be the future norm in our single network approach), the risk profile of the link would be substantially reduced and we would propose that this is being recognized by introducing different regimes for these two types of indirect links.

**Q45: Do you agree with the elements of the reconciliation method mentioned above? What would the costs be in the particular case of interoperable CSDs?**

Yes, we support the proposed requirements and note that most, if not all of our direct or indirect links are already compliant.

**Q46: Do you agree that DvP settlement through CSD links is practical and feasible in each of the cases mentioned above? If not explain why and what cases you would envisage.**

Yes, but in addition to the scenarios described above, we would need to add the situation where the receiving CSD does not provide banking service itself but has appointed a commercial settlement bank to provide commercial bank money services to its participants (including the participants of the requesting CSD). Another possible set up is for the national central bank of the receiving CSD to provide access to central bank money accounts to (participants of) the requesting CSD to facilitate settlement against payment over the link.

**Q47: Do you agree that the risk analysis performed by the CSD in order to justify a refusal to offer its services to an issuer should at least include legal, financial and operational risks? Do you see any other areas of risk that should be considered? If so, please give examples.**

No, as among the legal risks it should be contemplated that the "securities" to be issued are considered and recognised as actual security under national law and that national law does not prevent any such issue (a legal opinion should be required at least, however it should be noted that a legal opinion may not be a fully objective source of information as it will be drafted in the interest of the issuer.

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In addition, any non-compliance with AML, anti-terrorism financing, sanction regimes should be considered as a legal risk justifying refusal as well. Compliance considerations should be formulated in such a (practically applicable) way that in case of refusal of an issuer, the CSD knows the level of detail it has to provide to justify its negative decision. That level of detail must be consistent with the CSD's obligations under the AML Directive in particular with regards to "tipping-off".

In addition and due to the fact that the issuer has a "strong" right (= force to CSD to enter contract) to request admission of a CSD in another Member State than his home MS, a rule on the language of the issuance documentation should be put in place. Besides the home language, a certified translation in English (as lingua franca of the financial markets) or another major language of the EU should be required. Furthermore, each Member State should provide information to ESMA (and ESMA to the CSDs) on (i) whether there are independent reliable sources in its country for verifying the existence of the (share) issuer, the organs, the issued share amount etc. (e.g. Companies Register deemed to be trusted in public matters by law).

We would recommend that a far fuller consultation on these matters is undertaken together with the enforcement authorities (see our response to Q31 above).

**Q48: Do you agree that the time frames as outlined in the procedure above are sufficient and justifiable? If not, which time frames would you prefer? Please provide reasons to support your answer.**

No, it is neither reasonable nor proportionate for the regulatory authority to put itself in a position to force a CSD that it supervises to breach the standards of its compliance frameworks by requiring it to admit a security. Whilst it may be argued that ESMA would wish to respect the terms of a CSD's compliance framework, the interpretative burden that this imposes should not be underestimated. For example, third countries apply sanctions regimes extra-territorially and a CSD must therefore assess – often on the basis of unclear and untested legal assessments – the degree to which it is exposed to a risk of violation. It is also not self-evidently the case that compulsion by ESMA would constitute a sufficient mitigation in the case that enforcement actions were taken against the CSD.

**Q49: Do you agree that the time frames as outlined in the procedure above are sufficient and justifiable? If not, which time frames would you prefer? Please provide reasons to support your answer.**

The time frames proposed by ESMA seem to be appropriate. Having said this, besides regulating the link acceptance or refusal procedures, the technical standards should also establish a reasonable timeframe in which the link should be implemented. As link implementation timeframes, have been access barriers in some markets in the past.

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**Q50: Do you believe that the procedure outlined above will work in respect of the many links that will have to be established with respect to TARGET2-Securities?**

Yes, the procedure should take into account that all T2S CSDs will open links with each other and provide for a rule if the reason for a delay or refusal is T2S related. In addition, it should be taken into account that CSDs requesting to become a participant is equal to having a standard CSD-link, which may be standard, customised or interoperable. The procedures and timelines for granting access for CSDs as a participant and for standard CSD-link access should be aligned and timelines coordinated. Same applies, if there are authorisation requirements for interoperable CSD-links, in which case a CSD cannot comply with procedure above.

In addition, in any case and with a view to T2S, extension of the three-months' time period for requesting CSD to provide full written reasons for a refusal should be possible upon request of the CSD and should not be unreasonably withheld; one could think of requesting/confirming such extension by giving reasons for such exceptional circumstances with the competent authority.

**Q51: Do you agree that the risk analysis performed by the receiving party in order to justify a refusal should include at least legal, financial and operational risks? Do you see any other areas of risk that should be considered? If so, please give examples?**

No, Compliance risks have not been considered even though these may consume the greater part of a CSD's operating risk capital requirement. Please refer to our response to Q31 above. Additional legal risk to be considered is non-compliance with AML, anti-terrorism financing, and sanction regimes.

**Q52: Do you agree that the time frames as outlined in the procedure above are sufficient and justifiable? If not, which time frames would you prefer? Please provide reasons to support your answer.**

No, an extension of a three months period for a fully reasoned response upon dedicated request and reasoning by answering CSD should be granted by the competent authority.

**Q53: Do you agree with these views? If not, please explain and provide an alternative.**

Yes, we generally agree to such views

**Q54: What particular types of evidence are most adequate for the purpose of demonstrating that there are no adverse interconnections and risks stemming from combining together the two activities of securities settlement and cash leg settlement in one entity, or from the designation of a banking entity to conduct cash leg settlement?**

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Evidence is needed on what is to be considered as proper procedures and arrangements for Credit Risks resulting from the cash leg of a settlement instruction. Moreover, proper investment policy also needs to reflect positively the risk-adverse investments.

In addition, proper procedures on the “selection and monitoring” of cash correspondents including back up procedures and proper management of interconnections between cash correspondents, sub-custodians and treasury counterparties should be provided.

Additional elements to be considered are:

- The need for prompt access of the credit institution to the securities collateral related to its short term credit provision (i.e. this collateral will be located in the CSD),
- The alignment of recovery and resolution arrangements of the legal entities involved,
- The need to address possible conflicts of interest in the governance arrangements of the respective entities.

We trust you would have found these comments useful and remain at your disposal for further discussion. Should you have any questions please do not hesitate to contact:

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