

ECSDA Comments on the ESMA Discussion Paper on technical standards under the SFTR

This paper constitutes ECSDA's response to the [Discussion Paper](#) issued by the European Securities Markets Authority (ESMA) for public consultation on 11 March 2016, concerning upcoming technical standards under [EU Regulation 2015/2365](#) on securities financing transactions (SFTR). Although some central securities depositories (CSDs) and especially international central securities depositories (ICSDs) offer triparty services for securities financing transactions (SFTs), the majority of ECSDA members do not provide services which fall under the scope of the SFTR.

ECSDA's response is thus very succinct and does not focus on the role of triparty agents in SFTs. It only covers Section 4.3.7 of the Discussion Paper on the reporting requirements applying to the place of settlement (p. 83-86), which could potentially include information on all CSDs in the European Union.

1. Reporting fields on the place of settlement

Q122. Do you agree with the approach to identify the settlement information in the SFT reports?

In paragraph 280 (p. 85) of the Discussion Paper, ESMA explains that the "place of settlement" and the "CSD" are two separate fields for SFT reporting purposes:

1. **"Place of settlement"** is a field to be used in transaction reports. It appears as:

- Field 9 (p. 109) in Table 2 on Transaction data,
- Field 9 (p. 127) in Table 5 Transaction data,
- Field 9 (p. 143) in Table 8 on Transaction data,
- Field 9 (p. 159) in Table 11 on Transaction data.

This field is to be populated by a unique code (in principle, a Legal Entity Identifier) indicating either the CSD or the settlement internaliser *"where the settlement is agreed to take place"*.

2. “CSD” is a field to be used in counterparty data reports. It appears as:

- Field 14 (p. 106) in Table 1 on Counterparty data,
- Field 14 (p. 124) in Table 4 Counterparty data,
- Field 14 (p. 140) in Table 7 on Counterparty data,
- Field 12 (p. 156) in Table 10 on Counterparty data.

This field is to be populated by a unique code (in principle, a Legal Entity Identifier) “*in case the SFT settles through a CSDs link.*” The code should allow for the identification of the deliverer’s CSD, i.e. the CSD “*where the securities sold are held before the settlement (in case of transactions reported by the seller)*”, or the receiver’s CSD “*where the securities will be held after the settlement (in case of transactions reported by the buyer)*”.

ECSDA expects that, for a given SFT, both counterparties will report the same “place of settlement” but they may each report a different code in the “CSD” field. This is likely to be the case in cross-border scenarios where multiple CSDs are involved.

Furthermore, ECSDA understands from the wording of the Discussion Paper that the “CSD” field will only be required in counterparty data reports in case the SFT is settled through a CSD link. In other words:

- When the place of settlement is a CSD and in the absence of any CSD link, there is no need to populate the “CSD” field (it would be identical to the field “place of settlement”);
- When the place of settlement is an intermediary (settlement internaliser), since intermediaries’ accounts at CSDs do not qualify as “CSD link”, there is no need to populate the “CSD” field with the LEI of the CSD in which the securities are ultimately held or delivered by the intermediary;
- When the place of settlement is a CSD and the securities delivered as collateral are ultimately held in another CSD via a CSD link, the “CSD” field is required and should identify the issuer or investor CSD, depending on the reporting counterparty.

Generally speaking, ESMA should not underestimate the complexity of populating this field for counterparties, for example in case of multiple securities being part of the same SFT, in the case that the loan or the collateral are settled across multiple infrastructures, or in case the collateral consists in a basket of securities.

2. The role of CSDs in mitigating risks in SFTs

Q121. Do you consider that information on settlement supports the identification and monitoring of financial stability risks entailed by SFTs?

ECSDA remarks that some of the wording used by ESMA in Section 4.3.7 of the Discussion Paper does not accurately reflect the role played by CSDs in settling SFTs. We therefore recommend that ESMA takes into account the following considerations when drafting its final report and technical standards:

▪ **Concentration risk**

ECSDA agrees with ESMA that SFTR reporting should allow regulators to assess systemic risk, including as regards the potential concentration of SFT activity with certain actors, whether intermediaries or market infrastructures. We also remark that CSDs are subject to extensive reporting and recordkeeping requirements under the CSD Regulation (EU Regulation 909/2014), and that detailed records on SFTs have to be maintained by those CSDs providing SFT services.

Unlike what seems to be suggested by paragraph 275 (p. 84), CSDs do not exacerbate systemic risk but rather contribute to mitigate it, e.g. by reducing the likelihood of a settlement failure. Although a few infrastructures and intermediaries tend to concentrate the bulk of SFT settlement volumes, the number of CSDs in Europe is higher than in any other market in the world. The EU alone has 31 CSDs and it is thus difficult to argue that the limited number of CSDs constitutes a risk for SFT transactions in Europe.

Unlike CCPs, CSDs do not mutualise the risks of their participants. In fact, CSDs contribute to the resilience of the financial system by reducing risks related to custody and settlement for market participants. The collateral management services provided by CSDs help their participants guarantee transactions by effectively mobilising the available securities as collateral. CSDs also help central banks implement their monetary policy in the safest possible environment. Furthermore, CSDs help participants take remedial actions in the event of a settlement fail, thereby avoiding further contagion from the non-delivery of securities in case of linked transactions.

EU CSDs are highly regulated entities and any eventual remaining risks related to their functioning are addressed by the CSDR. The CSDR ensures their resilience and robustness, including in orderly-winding down and resolution scenarios. ECSDA recommends that Section 4.3.7 of the Discussion Paper should be redrafted to clearly state that the risks described in relation to the use of CSDs are addressed in existing legislation.

Paragraph 278 (p. 84) states that reporting the place of settlement would “*allow identifying concentrations at the level of settlement*” and would “*facilitate the analysis of operational and legal risks when looking for weak links or dependencies on systemically important market infrastructure*”. ECSDA partly disagrees with this statement. Irrespective of whether there is a triparty agent, the fact that several SFTs settle in the same CSD does not in itself create concentration risk. Indeed, securities used as collateral in the context of SFTs are ultimately held in CSD accounts and the fact that SFTs settle in these accounts rather than at a lower level of the holding chain (e.g. in the books of intermediaries) does not create any risk. On the contrary, the strict prudential framework applied to CSDs in Europe and across the world means that settling SFTs in CSD accounts entails less risk than settling SFTs outside of a CSD environment. The likelihood of a CSD failure is extremely low (and has no precedent, in Europe at least), especially compared to the likelihood that an intermediary fails. The occurrence of settlement

at CSD level (i.e. in the accounts of CSD participants) should thus be encouraged and cannot be considered as a “concentration of risk”.

For the same reasons, ECSDA disagrees with the statement in paragraph 280 (p. 85) that *“CSDs and direct and indirect participants, by virtue of the fact that they are providers of settlement and safekeeping services, could have a role in exacerbating the risks above [contagion risks, leverage building up and interconnectedness stemming from the re-use of collateral].”* In fact, the settlement and safekeeping of assets (i.e. collateral) in a central market infrastructure is CSDs’ ‘reason for being’. Stating that the use of a CSD (rather than decentralised settlement locations) could exacerbate contagion risks or leverage goes against the regulatory objective of promoting safe and transparent securities transactions through the use of central market infrastructures.

In the same paragraph (p. 86), ESMA states that: *“When SFTs are settled through chains involving several CSDs/ direct and indirect participants acting as “nodes” in a network of interconnected players, the respective entities could act as contagion channel across markets and geographical areas.”* ECSDA finds that CSD links should not be considered as a channel of contagion, but rather more as a secure proofing structure. Even though in principle any connection between two entities is a potential source of contagion, links between European CSDs are probably the safest channels of distribution across national markets. This is partly due to regulation on the design and risk management of CSD links (both through “hard law” like MiFID and the CSDR, and “soft law” instruments such as the international Principles for financial market infrastructures), which has no equivalent for intermediary-to-intermediary links. It is also due to the maturity of CSD links which have a solid track record, having been used for decades in Eurosystem cross-border collateral operations.

▪ Counterparty credit risk

Likewise, stating that the occurrence of settlement of numerous SFTs in a given CSD *“would allow the analysis of risks to a counterparty related with a failure of a CSD”* (p. 85) is only partly accurate in that market participants remain primarily exposed to their counterparties, not to the CSD. The vast majority of European CSDs are not exposed to counterparty credit risk in relation to their participants. Even those few (I)CSDs which operate with a banking licence have to abide by very strict prudential rules on credit and liquidity risk. These rules are specific to CSDs and more restrictive than those rules applying to regular credit institutions. They aim to ensure that CSDs remain safe and robust even in the most extreme scenarios.

3. CSD direct and indirect participants

Q124. Are there any practical difficulties with identifying CSDs and indirect or direct participants as well as, if applicable, settlement internalisers in the SFT reports? Would this information be available by the reporting deadline? Please elaborate.

In the “CSD participant or indirect participant” field, we understand that SFT counterparties will be asked to report an LEI code allowing for the identification of the intermediary *“that settles on behalf of the deliverer”* or *“that settles on behalf of the receiver”*.

This field appears as:

- Field 15 (p. 106) in Table 1 on Counterparty data,
- Field 15 (p. 125) in Table 4 Counterparty data,
- Field 15 (p. 140) in Table 7 on Counterparty data,
- Field 13 (p. 157) in Table 10 on Counterparty data.

ECSDA believes that ESMA should clarify the criteria for populating this field. Indeed, it is not entirely clear from the Discussion Paper in which cases SFT counterparties would be expected to report direct CSD participants, and in which cases they would be expected to report indirect CSD participants. For example, in case an SFT counterparty has an account with a global custodian who holds securities at a CSD via a local agent, should the SFT counterparty report the global custodian as indirect CSD participant, or the local agent as direct CSD participant? It would also be helpful to clarify whether this field will be required for SFTs settled outside of CSDs.

About ECSDA

The European Central Securities Depositories Association (ECSDA) represents 41 central securities depositories (CSDs) across 37 European countries. As regulated financial market infrastructures, CSDs play a vital role in supporting safe and efficient securities transactions, whether domestic cross-border. If you have any questions on this paper, please contact Ms Soraya Belghazi, Secretary General, at info@ecsd.eu or +32 2 230 99 01.