CENTRAL SECURITIES DEPOSITORY PRAGUE

Response to the Discussion Paper

Draft Technical Standards for the Regulation on improving securities settlement in the European Union and on central securities depositories (CSD)

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Discussion Paper

Draft Technical Standards for the Regulation on improving securities settlement in the European Union and on central securities depositories (CSD)

This paper constitutes the comments of the CSD Prague on the ESMA Discussion Paper of 20 March 2014 on draft technical standards for the CSD Regulation. It covers all questions of the consultation.

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

We do not have any comments.

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? Do you consider that this requirement should apply differently to investment firms? If so, please explain.

We support the opinion that CSDs should make no use, or very limited use, of manual intervention. On the other hand we see some exceptions that should be allowed manual interventions. These exceptions should include mainly cross-border transactions among CSDs and manual interventions in case of participant's technical issues. Due to different interfaces of CSDs would be expensive to adjust communication just for a few transactions per week. We estimate the overall costs around EUR 250 000.
We consider that this requirement shouldn´t apply to small investments firms, because some participants use front-end applications and adjustments according to STP would be very expensive. Therefore in case of implementation, a systematic importance of an investment firm should be distinguished according to value of assets or number of transactions.

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

The relevant communication procedures and standards should be based on ISO standards or open web services with publicly disclosed interfaces but the Level 2 legislation should not mandate the use of specific communication standards (e.g. ISO 20022). In case of a decision to implement mandatory ISO 20022 we would recommend a grace period of several years, because this requirement will have a huge impact on procedures and investments of many CSDs and investment firms.

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?

From our point of view the matching should be compulsory for all DVP transactions with exception of already matched transactions (trading venues or CCPs). FoP instructions shouldn't be mandatorily matched, because according to our rules a participant of the CSD is not necessary a participant of the settlement (matching) system, but still should be able to transfer securities. We agree with the proposed mandatory matching fields, but we think that there is no need for technical standards to go as far as mandating the use of certain matching fields. Regarding clients codes we recommend LEI if applicable, but due to additional costs and system changes the grace period will be necessary.

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

We agree that disincentives could be the effective way how to motivate participants to match transaction as soon as possible, but on the other hand we see a crucial issue how to recognize which instructions are late, because a field of the trade date is mandatory only for OTC trades.
Thus for other transactions (for example in T+0) is not possible to distinguish what is the late matching and these transactions we would exclude.
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.

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.

In our opinion 3 daily settlements/batches per day are sufficient, but in the absence of any evidence that this will reduce settlement fails, we do not think that ESMA should mandate a specific number of batches per day. In case of RTGS, current setup of the Czech National Bank clearing system works in batches and hence it is not suitable for the RTGS. We are not able to estimate the implementation costs of the third party, but we do not see significant benefit of this implementation.

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.

We do not think that is necessary to mandate any measures to facilitate settlement ISD.

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

Yes, we agree that CSDs should not be obliged to offer arrangements for the lending and borrowing, because the facility itself doesn't guarantee a sufficient pool of securities.

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.

We monitor settlement fails in our system automatically and also our regulator receives this data daily, so we would prefer to communicate just with national regulator and not to create additional communication channel. Reporting costs depend on a regular timing of the reporting (we would recommend monthly reporting). We would suggest also distinguishing exchange and OTC trades.

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

Our participants receive all information regarding their fails daily so they can calculate all reports they need. We are also able to provide the report of settlement fails to participant on their request (monthly).
We agree that in the future, participants should be able to view their fails data both as deliverers and as receivers 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 via CSD's interface.

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 assume that public information should be disclosed in an ESMA format and could look like as annual aggregation of the report described in Question 9. Technical standards could require annual aggregate/anonymized settlement fails data to be made available on a dedicated page on CSD's public websites.

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

CSD Prague reports settlement fails to its regulator on a basis of daily reporting of all transfers, so the regulator can analyze all necessary regulatory aspects of securities transfers. It means that current reporting system is absolutely sufficient, but on the other hand also very costly for us and our regulator. A special daily aggregate report would mean additional costs and implementation time.

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

We suppose that the aspect of assets not traded on the venues should be taken into consideration as well. In that case, the extension period could be longer.

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?

The buy-in mechanism are exclusively used for the enforcement of contractual obligations at the trading level, and it is unclear how such a process can be "policed" at the settlement level, even if the rules on buy-ins are contained in CSDs' rulebooks. We thus recommends that further discussions should take place between ESMA, market infrastructures and their users, after the consultation deadline of 22nd May, to consider what processes could be put in place to enforce the CSDR buy-in rules in 'non-CCP' scenarios.

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

We are of the opinion that it should be left to each CCP, trading venue or CSD to decide on the buy-in feasibility, taking into account the parameters to be established in the RTS. We do not consider necessary to setup technical standards for a coordination of multiple buy-ins.

Q16: In which circumstances would you deem a buy-in to be ineffective?
How do you think different types of operations and timeframes should be treated?

We think that buy-in should be applicable just for trades matched on trading venues and maybe for OTC trades. In case of other transactions (repurchase trades, buy-sell, lending, etc.) we would not recommend buy-in mechanism.

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

In case of OTC transactions we would prefer an average market price across trading venues and OTC market. It could be also considered possible to collect a cash premium (just a few %) as the compensation, but certainly it depends how the whole penalty scheme will look like.

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?

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.

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

Based on current experience, we believe that the threshold should not in any case be higher than 75% of 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.

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

CSD Prague does not have difficulties with ESMA's approach, but we think that CSDR technical standards should not impose segregation requirements on trading and clearing members.

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

Yes, we think that the above mentioned requirements are appropriate.

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.

We have doubts regarding the element E8 (Portability), because we consider difficult to guarantee the procedure ensuring timely and orderly settlement and transfer of clients' and participants' assets to another CSD in the event of a withdrawal of authorization. CSD can describe all possible services how to transfer the assets of clients and participants to another CSD, but without the guarantee that all assets and participants will be accepted by receiving CSD or that all clients and issuers will agree with this transfer, unless it would be further enforced by the Regulation.

We would like to ask ESMA to clarify that the items listed under points E2 and E3 of Annex I of the Discussion Paper (intended settlement dates, preventing fails and measures to address settlement fails) will not be required for a CSD to obtain authorization, at least in the first three years after the Level 2 standards on settlement discipline have been adopted.
A similar approach, but with a presumably shorter transition period, should be adopted for points C7 on recordkeeping and F3(2) as regards CSD secondary processing sites.

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 that this approach is appropriate.

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?

We do not see just a risk to become dependent on the revenues from the participation, but also to become dependent on the cost sharing from the participation (IT systems, employees etc.).
From our point of view, prohibiting CSDs direct participation in CCPs could be considered advisable and relevant, but we think that CSDR technical standards should not impose limiting participations to securities chain and other entities.

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.

Yes, we consider ESMA's approach adequate.

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

The current recognition procedure seems to be designed as an one-off exercise, whereas it should be an ongoing process.

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?

We do not agree with the proposal made by ESMA in § 110 of its Discussion Paper which would require CSDs to monitor not only their own risks, but also to the risks they pose to participants and other entities.
Technical standards should clearly state that the "dedicated functions" are attributed to an individual, but that this individual should be allowed to perform other functions, as long as any potential conflicts of interests are disclosed and managed.
We don't see any potential conflicts of interest to share the independent audit report with the user committee. On the other hand, we wouldn't recommend sharing the internal audit report with the user committee.

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?

We do not fully agree with the "minimum requirements" approach proposed by ESMA for CSD recordkeeping. CSD Prague believes in a different approach that ensures truly harmonised standards and a level playing field for CSDs would be more appropriate.
At a minimum, the following items should be removed from the list:

- settlement banks and cash accounts used by issuer – we don't see the reason, why these fields should be mandatory
- participants cash accounts – end of day balances – we are not able to receive this information and we don't see the reason why we should know it

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?

We understand ESMA's view on modality for maintaining and making such records available. We fully support the use of the LEI as a standard identifier for legal entities, despite additional implementation costs.

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, we fully agree with ESMA's reasons and we do not see any other areas of risk that should be required.

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.

We agree that the fixed time frames are sufficient and justified.

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.

In our opinion, the benefits of described reconciliation outweigh the costs. We have not measured such costs.

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.

We do not think that is necessary to consider the implementation of other reconciliation measures.

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 agree with ESMA's approach and we are sure that double-entry accounting principle gives a sufficiently robust basis for avoiding securities overdrafts, debit balances and securities creation.

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

In our point of view, this definition of the operational risk should be sufficient.

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.

We consider the proposed risk management framework sufficient and we do not recommend additional requirements.

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?

In our opinion the above proposal gives a sufficiently robust basis for risk identification and risk mitigation.

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

We do not agree with ESMA proposal stated in §167 of the Discussion Paper, to make mandatory an annual yearly review of the IT system(s) and IT security framework of all CSDs. A frequency of 3 to 5 years for such reviews appears more appropriate

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

We assume that key elements of the adequacy of resources, capabilities, functionalities and staffing arrangements of the secondary processing site should be based on types of crucial services provided by CSD, on systematic risk and overall impact on the market in case of a delay and on overall costs of the secondary site considering the overall income of the CSD. Regarding a geographic risk, mainly local hazards based on historical experiences as floods and other accidents should be considered. We would not recommend setting strict minimal or maximal distance between primary and secondary site and a sufficient requirement might be just a distant building.
T2S currently foresees a maximum recovery time of 4 hours for critical CSD functions, and not 2 hours as suggested by ESMA in the third bullet point.

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?

We do not consider other requirements necessary.

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?

Yes, we agree with ESMA's approach and we do not support making differences between CSDs that do provide banking services and CSDs that do not.

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

Regarding concentrations limits we would recommend considering also proportion of assets/exposures to single entity against CSD's equity capital, because we think that for example there can be just one single exposure, but without significant impact on the risk of the CSD.

Besides, we do not fully agree with ESMA's statement, in § 182 of the Discussion Paper, that *"CSDs should not be allowed, as principle, to consider their investment in derivatives to hedge their interest rate, currency or other exposures."* We thus recommend removing point (ii) from the list of criteria.

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.

We agree with the mentioned elements and we do not consider any additional risks.

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

In our opinion, the mentioned procedures are adequate to monitor and manage the additional risk arising from the use of intermediaries.

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 agree with these elements.

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 envis-age.

We agree that DvP is practical and feasible, but should be justified by market demand, a business case and a safe and efficient access. We would like to stress, that if the link is designed and used mainly to support dual listing, DvP should not be required.

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.

We do not see any other areas of risk that should be considered and we agree with ESMA's approach. It should also be clear that CSDs can, but do not have to, refuse issuers on these grounds.

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.

Yes we agree that the time frames are sufficient and justifiable.

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.

Yes we agree that the time frames are sufficient and justifiable.
Whenever the setup of the link requires developments (customised link), those costs would be at the expense of the requesting CSD (cf. point 218 b). The requesting and receiving CSDs will have to agree on the scope of development, cost and time frame as 8 months may not be sufficient for the developments.

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?

Currently we are not engaged in T2S project, so we are not able to comment this issue**.**

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?

We do not see any other areas of risk that should be considered and we agree with ESMA's approach.

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.

We do not understand why the receiving party should be required to provide access to the requesting party within 3 months of the order, while in other cases (CSD links – Q49 and access of issuers – Q48) there is a period within 3-8 months. We would recommend setting the same timeline 3-8 months or at least 6 months.

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

We agree with ESMA's 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?

We don't have any comments.

CSD Prague thanks ESMA for the opportunity to comment on the Discussion Paper on CSDR technical standards. For any questions on this paper, please contact Ondřej Dusílek +420 221 832 804 or email dusilek@pse.cz.