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| 18 December 2014 |

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| Reply form for the Technical Standards under the CSD Regulation |
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| Date: 18 December 2014 |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper - Technical Standards under the CSD Regulation, published on the ESMA website.

***Instructions***

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, please follow the instructions described below:

1. use this form and send your responses in **Word format**;
2. do not remove the tags of type <ESMA\_QUESTION\_TS\_CSDR\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
3. if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

1. if they respond to the question stated;
2. contain a clear rationale, including on any related costs and benefits; and
3. describe any alternatives that ESMA should consider

**Naming protocol:**

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA\_ TA\_CSDR \_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

E.g. if the respondent were ESMA, the name of the reply form would be ESMA\_TS\_CSDR\_AIXX\_REPLYFORM or ESMA\_CE\_TS\_CSDR\_AIXX\_ANNEX1

Responses must reach us by **19 February 2015**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input/Consultations’.

***Publication of responses***

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

***Data protection***

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Disclaimer’.

# General information about respondent

|  |  |
| --- | --- |
| Are you representing an association? | Yes |
| Activity: | Credit Institution |
| Country/Region | Europe |

##### Do you think the proposed timeframes for allocations and confirmations under Article 2 of the RTS on Settlement Discipline are adequate?

##### If not, what would be feasible timeframes in your opinion?

##### Please provide details and arguments in case you envisage any technical difficulties in complying with the proposed timeframes.

<ESMA\_QUESTION\_TS\_CSDR\_1>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_TS\_CSDR\_1>

##### Do you agree with the cases when matching would not be necessary, as specified under Article 3(2) of the draft RTS?

##### Should other cases be included? Please provide details and evidence for any proposed case.

<ESMA\_QUESTION\_TS\_CSDR\_2>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_TS\_CSDR\_2>

##### What are your views on the proposed approach under Article 3(11) of the draft RTS included in Chapter II of Annex I?

##### Do you think that the 0.5% settlement fails threshold (i.e. 99.5% settlement efficiency rate) is adequate? If not, what would be an adequate threshold? Please provide details and arguments.

##### Do you think that the 2,5 billion EUR/year in terms of the value of settlement fails for a securities settlement system operated by a CSD is adequate? If not, what would be an adequate threshold? Please provide details and arguments.

<ESMA\_QUESTION\_TS\_CSDR\_3>

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##### What are your views on the proposed draft RTS included in Chapter II of Annex I?

<ESMA\_QUESTION\_TS\_CSDR\_4>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_TS\_CSDR\_4>

#####  What are your views on the proposed draft RTS on the monitoring of settlement fails as included in Section 1 of Chapter III of Annex I?

<ESMA\_QUESTION\_TS\_CSDR\_5>

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<ESMA\_QUESTION\_TS\_CSDR\_5>

##### What are your views on the proposed draft RTS related to the penalty mechanism? Do you agree that when CSDs use a common settlement infrastructure, the procedures for cash penalties should be jointly managed?

<ESMA\_QUESTION\_TS\_CSDR\_6>

The members of the Association of Global Custodians’ (the “**AGC**”) European Focus Committee (the “Committee”)[[1]](#footnote-2) are grateful for the opportunity to provide comments in response to the European Securities and Markets Authority’s (“**ESMA’s**”) Consultation Paper: Technical Standards under the CSD Regulation, dated 18th December 2014 (the “**Consultation Paper**”).

The Committee largely supports ESMA’s proposals, but it also would like to raise the following comments and concerns.

The Committee supports ESMA's views expressed in paragraph 59 that it is important to harmonise the penalty mechanism and to apply a single model across the Union.

The Committee supports the proposal that CSDs pass on relevant information to CCPs so that CCPs can charge, and compensate, their clearing members.

The Committee supports ESMA's conclusion that when CSDs use a common settlement infrastructure the procedures for cash penalties should be jointly managed. In particular it would be preferable if a common platform like T2S concentrated on the following services:

* Collect / report information on the failed transactions per CSD
* Calculate the penalties as per the RTS requirements
* Report the results to the respective CSDs for their own participants
* Issue the respective bills to the CSDs

The actual debiting and crediting of the amounts would be something which CSDs would better perform themselves as part of their billing process. Here it should be noted that CSD participants do not have a contractual relationship with T2S but only with their respective CSD.

In a scenario involving multiple CSDs it needs to be ensured that penalties can be passed through CSDs. In this context the Committee member believe that the account setup within the CSD links needs to be designed in a way to support the “pass-on” principle.

We fully agree with ESMA’s acknowledgment in paragraph 37 of the Consultation Paper on the Technical Advice, the penalty “is not designed to replicate exactly the loss incurred by the failed participant, or the gains achieved by the failing participant”; in the same paragraph, the Paper further explains that the penalty “is not structured to compensate for the loss that a counterparty may suffer and that is part of the contractual arrangement between the counterparties”, and that it “is an add-on to any claim in compensation that the failed party may contractually have over the failing counterparty”.

The Committee also believes that the proposed design of the penalty does include the possibility for anomalies for which further clarification is needed by ESMA

Here are two examples of possible anomalies:

* **Immunization of a participant in a settlement chain**

The Committee believes the regime as designed does not perfectly take into account the partial settlement mechanism since most of the CSDs use a threshold in quantity and/or in amount. As a result participants, in particular CCPs, could face penalties for transactions which are not settled due to a threshold applied by the settlement system.

Any penalty system should take this into consideration and not charge the participant for the failing amount. Moreover, this issue could be resolved by clarifying in the Technical Advice that, where a partial delivery is not possible due to partial settlement restrictions regarding the Minimum Settlement quantity and settlement unit multiple, the penalty should only be calculated on the actual missing amount.

Example:

* The threshold for triggering a partial settlement is a quantity of 500 shares
* C to receive 200 shares from A: failing
* C to receive 400 shares from B: settled
* C to deliver 600 shares to D: failing for 600 (400 is less than the threshold)
* C will be penalized for 600 and indemnified for 200

Applying the above logic and assuming that C&D have opted for partial settlement, C should only be penalized for 200 shares (which indeed are missing).

* **Opt-out**

The Committee believes the suggested regime may potentially not capture a real short-selling participant.

Example:

X is a CSD and at the end of the ISD starts the settlement regime process. What X sees is:

* a settlement instruction between A and B for 200 shares which is unsettled
* a settlement instruction between B and C for 1000 shares which is unsettled (moreover C has opted out)

These two fails have to be charged

* For A it is simple: A should be charged for 200; the penalty should be given to B
* For B it is more complex due to the fact that C has opted out of partial settlement

The draft TA provides:

*28. In the proposed draft RTS, CSDs are required to offer the “partials” functionality to their participants. This measure aims at facilitating the settlement, even for a part, of the settlement instruction. Following that approach, when a receiving participant does not accept partials, the penalties applicable to the failing delivering participant* ***should only apply to the missing financial instruments*** *or the missing part of the cash. As the impossibility to partially deliver is due to the choice of the receiving participant, the delivering participant should not be penalized. (Point 28 of CP on TA)*

Therefore, X (the CSD) is required to apply the penalty for B only **to the missing financial instruments**.

**The question that arises is: what are the “missing financial instruments”?**

* **the “200” that are missing? (option 1)**
* **The difference between the 1000 (B should deliver to C) and the 200 (B should receive from A) = 800? (option 2)**

We emphasise that there **there is no mention in the ESMA proposal of a need to check what is in B’s account.**

**The main concerns of the Committee are as follows:**

1/ The design of the penalty mechanism may create a need for direct bilateral claims; this would be the case, for example, if the penalty mechanism generated compensations in cases where no compensation was due, with the result that counterparties would have to correct the penalty flows.

2/ The potential volume of penalty data will be very high; this will require intermediaries in the custody chain to reconcile the data and charges that they receive from their account provider and then pass on the data and charges to their clients; given the volumes, a system should cater for an automatic transfer of information.

3/ The current design of the mechanism, as set out in Articles 7 and 8 of the draft RTS on settlement discipline, is insufficiently detailed and precise to ensure an outcome of each CSD in Europe applying the same penalty mechanism.

4/ Under some circumstances the penalty mechanism may have the effect of creating a disincentive, or even an obstacle, to the sending of settlement instructions to the CSD. This would be the case, for example, if the operation of the penalty mechanism meant that sending a settlement instruction to the CSD generated significant risk for intermediaries in the custody chain; in such a circumstance it is conceivable that prudential supervisors would prohibit the transmission of settlement instructions if the underlying trading party had insufficient resources for settlement. Such a situation would impair the efficiency of the settlement system.

The Committee believes that some important elements are that ESMA ensure that the following information be publicly available which would enable the penalty system to work in a harmonized way:

* a list of the ISINs of all the securities that are subject to penalty fines;
* for each ISIN, and for each business day, the price to be used for the calculation of penalties; and
* the penalty rate to be applied for a specific ISIN.

The list of ISINs is necessary as – without an authoritative list – each CSD would find it difficult to find the necessary information, and there would be a risk that different CSDs charge based on different lists. The background to this requirement is that not all securities will appear on the list, as CSDR excludes from the penalty charge regime securities that are not cleared by a European CCP and that are not admitted to trading on European trading venues, as well as securities for which the principal venue for trading is located in a third country.

Without the price list, there would inevitably be differences in the prices used by different CSDs. Although paragraph 27 of the draft Technical Advice does give some indications as to how the price should be derived, it is not fully clear: for example, it does not specify that the price applied per (failed) settlement day should be the market price for that day.

Additionally, Committee members have compiled a list of questions in order to help clarify aspects of the design of the penalty mechanism, together with some proposed answers, and other commentary.

*1/ Does the penalty apply just to free and against payment securities transfers, or also to pure cash transfers that may be processed by a CSD (such as Payments Free of Delivery (PFOD))?*

The current text suggests that the fines may also apply to pure cash transfers. This is because the penalties apply to failed settlement instructions, and the draft RTS defines a settlement instruction as being a transfer order, under the Settlement Finality Directive of a transfer order, which includes both cash and securities transfers. The Committee suggests that the penalties apply just to securities transfers.

*2/ Does the penalty apply to all types of securities transfers?*

To avoid uncertainty ESMA should provide list of transaction codes which are in scope of the settlement penalty regime.

*3/ Will there be penalties for instructions that are subsequently cancelled?*

The current text of the draft RTS does indeed suggest, without being totally explicit, that there should be a penalty for bilaterally-cancelled matched instructions. But it is unclear what the justification is for this. If both parties agree to cancel a transaction, it is unclear why there should be a centrally-generated penalty. The Committee believes that it is clear that there be no penalties calculated for bilaterally-cancelled matched instructions prior to the end of ISD. However, the question remains whether matched instructions that are bilaterally cancelled post ISD should incur a settlement fine.

*4/ What is the exhaustive set of circumstances that would trigger a penalty? Is it simply shortage of securities, shortage of cash, and hold status of an instruction? Or will other causes of non-settlement also generate a penalty?*

The Committee suggests that shortage of securities, shortage of cash and hold status be the exhaustive list of triggers.

*5/ What happens if there are two triggers, so that both the receiving party and delivering party prevent settlement? What would happen, for example, if both parties put their instructions on hold.*

The Committee suggests that if both parties trigger a penalty there should be no penalty.

*6/ What would happen if there is an external reason that prevents settlement, such as, for example, a CSD freezing activity in an ISIN, or a particular securities account? In this case, should the participant with the trigger (for example, shortage of securities) be penalised?*

The Committee suggests that in such circumstances there will be no penalty. A list of some reason codes can be found at the following link: <http://www.iso15022.org/uhb/uhb/mt548-12-field-24b.htm>. This list displays the fail-reasons that currently exist. We do not believe that all of them should incur a fine. Ideally, ESMA clarifies this based on the ISO codes already.

*7/ How shall “backdated” transactions be treated in the calculation? If both parties send their instructions late, which party would be penalised?*

We appreciate that ESMA rightly concluded that instructions should be penalised if they are entered late into the settlement system. We would encourage ESMA to further clarify that if both parties send their instructions late, it is the last instructing party who should be penalised if the instruction settles on the same day. More information is needed as to the methodology for calculating backdated fines, as it is by no means clear that CSDs will have all the information necessary to calculate such fines.

*8/ Is the potential exposure of a CSD participant unlimited?*

The Committee believes that the logic of the current ESMA proposal is that the potential exposure of a CSD participant is not unlimited, in that after a fixed number of days a buy-in should be executed and the original transaction cancelled. However, and as pointed out in the Committee answer to question 7, there will not always be a buy-in for every single transaction, so that the question of unlimited exposure is valid.

The unlimited exposure arises because on a matched instruction there is no possibility for the CSD participant to cancel unilaterally the instruction, and because a penalty is calculated for each day of non-settlement. The question is particularly important because penalties are calculated on an ad valorem basis.

The Committee suggests that ESMA review this issue, and ensure that such potential exposure not be unlimited. If it were unlimited, then this would impose significant risk on CSD participants that act as a settlement agent. This could have balance sheet implications, and may also raise concerns by prudential supervisors. One way of limiting the potential exposure could be by fixing a limit to the number of days for which a transaction is subject to a penalty.

As a final comment, it should be noted that Articles 8 and 9 of the draft RTS on settlement discipline suggest that penalties are paid only by failing delivering participants, and are received only by receiving participants. For example, Article 8(1) states that the CSD shall redistribute the amount of the collected penalties to the “receiving participant that suffered from the fail”. The Committee would appreciate a clarification that a penalty should be applied to the participant causing the fail and redistributed to the party suffering from the fail.

<ESMA\_QUESTION\_TS\_CSDR\_6>

##### What are your views on the proposed draft RTS related to the buy-in process?

##### In particular, what are your views on applying partial settlement at the end of the extension period? Do you consider that the partialling of the settlement instruction would impact the rights and obligations of the participants?

#####  What do you think about the proposed approach for limiting multiple buy-in and the timing for the participant to provide the information to the CSD?

<ESMA\_QUESTION\_TS\_CSDR\_7>

The Committee believes that the draft RTS related to the buy-in process are fundamentally flawed.

The Committee believes the most critical flaw is that – for transactions that are neither cleared nor executed on a European trading venue – the draft RTS place the responsibility for executing and processing the buy-in at the settlement layer (i.e. CSD and CSD participants), and not – as it should be – at the trading layer.

This requirement changes the role of settlement agents and custodians. It transfers counterparty risk from the trading level to the settlement level. This is a fundamental change in the responsibilities of actors in securities markets with far-reaching implications. The Committee opposes this change strongly. The Committee asks ESMA to reconsider its proposals, especially as there are broader policy implications and concerns, relating to systemic stability and prudential supervision.

**1/ Level 1 mandate**

As ESMA points out in paragraph 67 of the consultation paper, the Level 1 text of CSDR does indeed require ESMA to specify “the details of operation of the appropriate buy-in process”.

However, the Level 1 text does not require that for OTC transactions (i.e. those that are neither cleared nor executed on a European trading venue) the buy-in process be executed at the settlement level. In fact, if anything, the Level 1 text suggests precisely the reverse. The Level 1 text (in Article 7(15)(h)) asks ESMA to specify “necessary settlement information”, but this requirement relates exclusively to the case of uncleared transactions that have been executed on a European trading venue, and specifically does not relate to OTC transactions.

The conclusion is clear. It is fully within the scope of the Level 1 mandate for ESMA to specify details of a buy-in process that takes place at trading level.

**2/ Change in Risk Profile**

The ESMA requirements for buy-ins for OTC transactions have significant risk impacts for all participants in a securities holding chain, and for all types of transactions.

Article 11(3) of the ESMA draft RTS on Settlement Discipline specify that “The CSD, CCP, trading venue or the receiving participant shall appoint a buy-in agent or execute the buy-in by auction”.

This text works for CCP-cleared transactions, and for transactions executed on trading venues, provided it is clear that the relevant participant in such cases is the participant in the CSD and in the trading venue. The Committee suggests that this text be clarified accordingly.

With regard to OTC transactions, the text requires that the buy-in be executed either by the CSD or by the receiving CSD participant or by an agent (appointed either by the CSD or by the receiving CSD participant). We believe that whether the agent is appointed by the CSD or by the receiving CSD participant does not make any difference; the CSD will not take on any risk, which means the buy-in will be executed in the name of the CSD participant, and the CSD participant will be contractually obliged to meet the commitments set out in the buy-in transaction.

When a buy-in occurs, the receiving CSD participant is exposed to the risk that it might not be reimbursed for the cost of purchasing the securities. For a securities settlement instruction against payment, the exposure is equal to the excess of the buy-in cost (including costs of the buy-in agent) over the cash settlement amount of the original settlement instruction. (This is on the assumption that the receiving CSD participant has received from its clients the necessary cash resources to settle the original securities settlement instruction). For a Receive-Free securities settlement instruction, the receiving CSD participant will need to be reimbursed for the full cost of the buy-in; in such a case, it is believed that the receiving CSD participant will need to be reimbursed by its client for the original purchase amount. In both cases (i.e. free and against-payment settlement instructions), it is believed that the delivering CSD participant should reimburse the receiving CSD participant for any excess of the buy-in cost over the original purchase amount. (It should be noted that this explanation is largely based on an interpretation of Article 7(8) of the Level 1 text (Article 7(8)): the draft RTS do not set out a reimbursement process).

This process has as a consequence that – depending on the specific settlement arrangements for a participant’s securities transaction - a receiving CSD participant may be dependent on reimbursement by any of the other participants in the same CSD, and by any of the participants of any interoperable CSD. It is important to note that the CSD participant does not have any direct contractual relationship with any of these other CSD participants, and indeed may not know their identity or contact details.

When a buy-in occurs, the delivering CSD participant is also exposed to risk. The delivering CSD participant is obliged to reimburse the receiving CSD participant for the excess of the buy-in cost over the original purchase amount. However, the delivering CSD participant may also be obliged (in accordance with Article 7(6) of the Level 1 text) to reimburse the receiving CSD participant for the short-fall (i.e. for the amount by which the cost of the buy-in is below the purchase amount of the original transaction).

What this analysis shows is that by sending securities settlement instructions to a CSD for matching and for settlement, CSD participants, both as receiving participants and as delivering participants, and as a consequence of the approach of the draft RTS to mandate a buy-in process at the settlement level, take on additional risk. The beneficiary of this transfer of risk is the underlying purchaser. The underlying purchaser benefits from a guarantee on the commitments of the underlying seller; the guarantors are the two CSD participants. In effect, the CSD participants take on the role of a Clearing Member for the purchaser.

This analysis is in part a partial analysis. CSD participants do not simply take on counterparty risk; they also take on legal risk. It is reasonable to assume that in some cases the two trading parties, or rather at a minimum the underlying buyer, challenge the right of the receiving CSD participant to execute the buy-in, and refuse to accept the outcome of the buy-in as replacing the original contractual agreement. This case could certainly occur in the case of contracts that are not under the law of a member state of the EU, and in the case of trading parties domiciled outside the EU.

The reason this possibility exists is because the mechanism whereby the underlying trading parties are obliged to comply with the requirements of European law are the contractual arrangements between the different parties in the different custody chains, and trading parties domiciled outside the EU could take the view that their domestic legal arrangements prevail.

**3/ Implications/Consequences of the Change in Risk Profile**

The Committee believes that this change in risk profile will have far-reaching implications. At this point in time, it is difficult to identify all the possible consequences. However, the Committee offers the following list of some possible implications and consequences:

1. Collateralization of exposures: in order to cover the increased risk, intermediaries will ask their clients to provide increased guarantees, and possibly collateral; this will tend to reduce the supply of collateral, and the supply of securities positions that can be borrowed, so that there will overall be a reduction in settlement efficiency.
2. Supervisory implications: prudential supervisors will require risk mitigation measures (such as the provision of collateral), and indeed may decide to prohibit certain entities from providing settlement agent and custody services; we note that this may well apply to investor CSDs, as CSDs in their role of an investor CSD will be exposed to buy-in risks.
3. System risk implications: the risks associated with buy-ins will be at their greatest at times of market stress (when market prices may fluctuate considerably, and when there may be little trading and settlement liquidity).
4. In a worst-case scenario, CSD participants in order to prevent their risk of facing a buy-in on their client’s transactions would withhold their respective instructions until they can be certain that the instructions would subsequently settle. Such behavior would be detrimental to the overall objective of increased settlement efficiency.

**4/ What is the right level (trading or settlement)?**

A major source of confusion is that CSDR, both at Level 1 and in the current draft RTS), categorises a buy-in as a settlement discipline measure.

Fundamentally, a buy-in is not a settlement discipline tool; rather, it is a tool to manage counterparty risk; a buy-in is the exercise by a trading party of a right to change the form of the obligation of the counterparty (in the event of non-compliance by the counterparty). For a buy-in to work, the right to a buy-in has to be an inherent part of the legal contract between the two trading counterparties.

As a buy-in is a right under a legal contract between two parties, it is very difficult for a third party (a receiving CSD participant, or a CSD, or a buy-in agent appointed by the CSD or CSD participant) who may not have any contractual relationship with the two parties to exercise that right.

To give a couple of examples (based on the proposed RTS):

1. Article 11(8): this paragraph states that the “receiving participant shall choose to defer the buy-in or to receive the cash compensation”. In the case of an OTC transaction, and of a receiving CSD participant that is not a party to the original trade, the receiving CSD participant could not exercise this choice. This choice could be exercised only by the underlying buyer.
2. Article 15(a): this paragraph covers the case of participants pre-agreeing a mechanism to establish the amount of a cash compensation. In the case of an OTC transaction, and of a receiving CSD participant that is not a party to the original trade, the receiving CSD participant could not pre-agree this. Only the underlying buyer can do this, together with the underlying seller.

The conclusion is inescapable. The right level for buy-in processing is at the trading level, and not at the settlement level.

**5/ What is the right way forward?**

The Committee believes that, if properly calibrated, some of ESMA’s proposals can work in the case of CCP-cleared transactions and where the CSD participant is also the trading party. However there are some cases were we think the proposal could encounter some difficulties.

In order to make the proposals workable, the Committee believes the following is needed:

* Clarity on scope of instrument: as with the settlement penalty regime, ESMA should publish a list of financial instruments considered in-scope of the buy-in regime together with the relevant extension period;
* Clarity on scope of activities: ESMA should specify what activities are in or out (ideally this should also be aligned to the transaction types that are reported by the CSD participants and the trading parties);
* Clarity on types of contracts (EU / Non-EU);
* Clarity on underlying trading parties (EU/Non-EU);
* Full recognition that contracting parties have the full contractual freedom to modify a transaction;
* Clarifying that the obligation to effect/process the buy-in can be placed on CCPs/CCP-participants and TVs/TV-participants, but it cannot be placed on CSDs/CSD-participants as such;
* Clarity on conditions for buy-in; and
* Requirements for contractual chain / requirements for information at CSD level.

**6/ a potential alternative solution**

The Committee believes that the key pillars of an alternative regime in line with CSDR Level 1 text are as follows:

1. CSDs should take no active role in the Buy-In process: their role should contain the monitoring activity, receiving information back from their clients on the status of a potential buy-in and report the status to the involved CSD participants. The Committee believes that buy-in information is extensive, complex, trading-related information that changes during the lifecycle of a securities transaction. There is currently no mechanism to transmit this information in an automated way to the settlement level. Even if such transmission were possible, the information that would be available at the settlement level could be partial information that would be of little use to supervisory authorities. There are alternatives for supervisors and regulators to receive the appropriate information, i.e., through reporting by the trading parties.
2. CSD participants should only be obliged to execute a buy-in if they are the actual trading party, i.e., managing their own positions (this would also be the case in an “account operator” model): CSDs could outline the different responsibilities in their internal documentation.
3. CSD participants in a Client/Omnibus-Set up will be required to inform their clients throughout the chain to determine the final trading participant. CSD participants would therefore neede to include provisions to this effect in their agreements with their clients, who in turn (where required) will have to include the same in their agreements with their underlying clients. This is in line with Art 7.10 of CSDR. Re-negotiation of contracts would incur significant legal costs (multiple millions in EUR) as well as requiring significant lead-time for implementation of an estimated 18-to-36 months. This process however can only be initiated when there is full clarity on the scope of the buy-in obligation as outlined in our points above. Without this added clarity, we envision related legal risk, which will be a major obstacle to the provision of custody services and to the access by non-European investors to European markets.
4. With definition of the trading participants, provision should be made that Buy-Ins are to be enforced at the trading level between counterparties to the trade. Their agreements/standard industry rules will need to be enhanced to refer to the mandatory obligations imposed by CSDR Level 1 text and the RTS. Such changes will have to be done on a harmonised basis across Europe. In addition, CSDs and trading venues will include in their internal rules and obligations for their members the obligation to apply Art. 10 of CSDR.
5. Who will execute the buy-in: where a CCP is involved (who has become a counter-party through novation), it is the CCP who will execute the buy-in by appointing a buy-in agent or using an auction tool. Where no CCP is involved, it is the prejudiced receiver/buyer who initiates the buy-in (unless he caused the fail by having insufficient cash resources). Notices of the relevant parties and modalities (extension period, deferral, quantity and timing etc) will be passed by the trading counterparties through the chain of settlement intermediaries back to the CSD for reporting and monitoring purposes.
6. Procedure: If a mandatory buy-in is to be initiated between trading counterparties according to the timeframes and modalities of CSDR, the prejudiced receiver should send a buy-in notification to the delivering party in a format which can be processed automatically. The delivering party will verify (as today) what caused the fail, and has two options:
	* If the delivering party is the one who caused the fail, that party should acknowledge the receipt of the message and would not need to do anything further: it will eventually be bought in. The prejudiced party and the delivering party also advise their respective settlement agents of the notice. This information should be fed back to the CSD for reporting purposes.
	* If the delivering party’s delivery fails because of external circumstances, e.g., an incoming receipt which is also failing, then it can/should ‘pass on’ the buy-in notice to the party who fails to deliver to the prejudiced party. This “pass-on” notice must be in a machine-readable format. As a result, the delivering party will inform its settlement agent of the receipt of the buy-in notice and thus “pass-on” to the other failing party.
	* Upon execution of the buy-in through the buy-in agent, the receiving party (which has initiated the buy-in) will inform its direct party and the CSD of the result, which will then cancel the underlying instruction. The same information flow is anticipated through the other parts in a chain transaction (buy-in execution = trigger for transaction cancellation). CSDR L-1 specifies that penalties are to be calculated until the end of the buy-in process or until the transaction settles. As a result, as long as the buy-in process has been completed (i.e., securities have been delivered), the underlying transaction can still settle.

When a CCP, which is exempt from the buy-in process, is part of a “chain” it is assumed that the CCP on its side would initiate a buy-in. This information needs to be brought to the attention of the receiving party by requesting the buy-in to be stayed until the CCP has executed the buy-in on its own, ideally in a machine readable format to allow automatic processing and updating. Such a process would help limit the execution of multiple buy-ins and avoid the requesting CSDs having to perform intensive validation of data. However, despite the industry currently analysing the possibilities to develop automated messages, there is currently no market practice in place for a buy-in message. As a result this would have to be developed prior to implementation and will take several years.

With regard to the suggested mandatory partial settlement, the Committee believes that since the buy-in process should apply only on the missing quantity, we agree that the opt-out flag needs to be dismantled before the buy-in occurs allowing the defaulting party to deliver the quantity available on its account.

The time-frame to dismantle, using the opt-out flag, should intervene between ISD and end of the extension period to facilitate settlement before the beginning of the Buy-In procedure. This dismantlement could occur after ISD + 2 or ISD +3. This would enable participants in a transaction chain to effectively use the securities and potentially cure other fails as well.

However we do not fully share ESMA’s proposal as described on point 84 on the CP on RTS (page 27):

“As a result and in order to achieve settlement, it is necessary to reserve the securities standing on the account of the participant for the purpose of that settlement instruction.”

Financial instruments are fungible; there is no rationale for reserving them in anticipation of a future delivery where the counterparty has opted out. Should there be no other settlement on the same account, there obviously is no need to reserve the securities. Should there be a reception and another delivery, and assuming that the reception is failing, financial instruments that are on the account should be used to settle the delivery in order to fulfill settlement and avoid more failing settlements.

<ESMA\_QUESTION\_TS\_CSDR\_7>

##### What are your views on the proposed draft RTS related to the buy-in timeframe and extension period?

<ESMA\_QUESTION\_TS\_CSDR\_8>

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##### What are your views on the proposed draft RTS related to the type of operations and their timeframe that render buy-in ineffective?

<ESMA\_QUESTION\_TS\_CSDR\_9>

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<ESMA\_QUESTION\_TS\_CSDR\_9>

##### What are your views on the proposed draft RTS related to the calculation of the cash compensation?

<ESMA\_QUESTION\_TS\_CSDR\_10>

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<ESMA\_QUESTION\_TS\_CSDR\_10>

##### What are your views on the proposed draft RTS related to the conditions for a participant to consistently and systematically fail?

<ESMA\_QUESTION\_TS\_CSDR\_11>

The Committee believes that the basic test (a settlement efficiency percentage that is 10% below the average settlement efficiency percentage of all the SSS participants, on more than 10% of the settlement days during the year) is reasonable.

The Committee believes that the current text of Article 16 of the draft technical standards needs to be modified so that it is clear that the daily calculation compares the settlement efficiency of the participant for that day with the average settlement efficiency of the SSS for that same day. (If the comparison were between the daily settlement rate of the participant and the annual settlement efficiency of the SSS, then on some days of the year every participant will be below the annual average).

The Committee notes ESMA remarks in paragraph 110 of the consultation paper that there is no automatic suspension of a participant. This is, of course, important as there are many factors, including many that are beyond the control of the CSD participant, that may explain a low settlement rate.

A factor that is very important for Committee members is that many CSD participants act as settlement agents for third parties, and thus are dependent on the operational processes of their clients; another relevant factor is that individual settlement failures that bring down the percentage of a CSD participant may be caused not by the CSD participant or by its client, but rather by the counterparty of the client. As a consequence, Committee member propose to exclude CSD participants from the risk of suspension in their activity as settlement agents.

With reference to the text in paragraph 109, it should also be noted that with T2S, and with improvements in settlement interoperability between SSSs, there is no longer a one-to-one relationship between markets and SSSs, so that, for example, participants in a market with structurally low settlement efficiency may choose to settle in an SSS with a high average level of settlement efficiency; this is another example of a relevant factor beyond the control of a CSD participant.

As a general note we should like to point out that Settlement efficiency under this article should only consider those transactions, which the CSD participant can actually control. In a very drastic scenario, a long-only investor could be suspended if its purchases do not settle despite having the subsequent cash available. The reason for settlement failure could be due to short positions of counterparties.

Additionally, ESMA might consider requiring CSDs to use a staggered approach, including pre-warnings before a participant is suspended. On the suspension itself, the Committee believes that this is an administrative act which should only be ordered by a competent authority.

<ESMA\_QUESTION\_TS\_CSDR\_11>

##### What are your views on the proposed draft RTS related to the settlement information for CCPs and trading venues?

<ESMA\_QUESTION\_TS\_CSDR\_12>

The Committee supports ESMA’s view set out in paragraph 114 that settlement information for CCPs and trading venues should be instruction/transaction-related.

With respect to Article 17 of the draft technical standards, the Committee has the following suggestions:

* 1(c): Replace “participants” with “CSD participants”; the rationale is that the CSD can identify the receiving and delivering CSD participants in a securities settlement instruction/transaction, but may well not be aware of the participants in the trading venue and/or the CCP.
* 1(d): Replace the current text with “The number and identification of the financial instruments for which settlement did not occur”; the rationale is that this is a concrete figure that CSDs can provide; a requirement to provide a figure relating to “missing” financial instruments would require CSDs to make a judgment call. CSDs do not necessarily have the full information to identify “missing” financial instruments.
* 1(e): Replace the current text that identifies five points in time with text that specifies that CCPs and trading venues should be able to receive updated information at least once per business day; this is a more demanding and a more generic requirement; the current text appears inappropriate as – as a general rule - CSDs will not have the relevant information allowing them to identify these points in time.
* 1(f): This should be deleted as it duplicates item 1(d).
* 2: Add “any” to the current text so that the text runs as follows: “….shall indicate in its settlement instruction the details and any reference …..”; the rationale is that the trading parties may not have a reference from the trading venue that they can include in the settlement instruction.

<ESMA\_QUESTION\_TS\_CSDR\_12>

##### What are your views on the proposed draft RTS related to anti-avoidance rules for cash penalties and buy-in?

<ESMA\_QUESTION\_TS\_CSDR\_13>

The Committee believes that Article 19 may generate legal risk for all parties involved in the trading, clearing and settlement process. Accordingly, the Committee suggests that ESMA review the Article, and, if appropriate, delete it.

The concern of the Committee is that this Article may create the risk that a process or mechanism that is compliant with the final text of Section 2 or Section 3 of Chapter III of the regulation (including certain exceptions where relevant) may be assessed as non-compliant with the RTS because this process or mechanism does not meet the additional requirements that are set out in the current text of Article 19 (a) and (b).

In effect, the risk is that the very broadly drafted requirements of Article 19 would supersede many of the detailed, technical provisions of Sections 2 and 3 of Chapter III.<ESMA\_QUESTION\_TS\_CSDR\_13>

##### Do you agree that 18 months would be an appropriate timeframe for the implementation of the settlement discipline regime under CSDR? If not, what would be an appropriate timeframe in your opinion? Please provide concrete data and evidence justifying a phase-in for the settlement discipline measures and supporting your proposals.

<ESMA\_QUESTION\_TS\_CSDR\_14>

We agree with the proposal to provide more time for implementation. In the context of a commonly operated platform, such penalty regime should be operated centrally as this is perceived to provide the most efficient results. Ideally such a settlement discipline regime would operate through all CSDs in a centralized manner. While developing a uniform process to run the settlement discipline regime might require a significant investment of time and resources, it would be less costly than if 24 CSDs were to build their own systems individually. Moreover, CSD participants in multiple markets would be prevented from having to invest 24 times to implement such a system. In addition, the system would have to cater to non-T2S CSDs and relations with non-EU CSDs.

In order to deliver a central system, however, certain processes would have to be fulfilled. As a first step, users of the platform would have to agree on a common set of user requirements that would then be implemented (in the example of T2S this information gathering started in 2006 and is still ongoing). We trust that T2S can provide sufficient comments which enable ESMA to anticipate the duration of such implementation efforts. Also, and in order not to endanger the migration of such a central platform, development timelines need to be taken into consideration. T2S has yearly release cycles so the implementation schedule for the RTS must proceed on a similar timeline.

In addition to building such a system for CSDs, CSD participants would be tasked with replicating the system developed by CSDs in order to identify the relevant trading desk or the underlying client which has caused a fail or would be entitled to a penalty distribution. Naturally such development can only start once the actual requirements and specifications from the CSDs are known. This would have to be factored into the billing processes. A significant lead time of about 12months following clarity on the actual requirements would be needed.

It should be noted that the application of new settlement disciplinary measures under the RTS would require several technical changes to the T2S platform in Q2 2017 (i.e. approximately 18 months delayed application). Applying these new standards before T2S has been properly implemented and tested will endanger the success of the migration of T2S as a whole due to the technical complexity of introducing changes to a system that is being tested or migrated. As per current time lines it is anticipated that the “last-wave” CSDs would have to implement changes to their (legacy) systems around February 2017 while they are in the middle of their migration to T2S. This could incur significant throw-away costs not only by the CSDs but also by participants active in those markets.

A phased-in approach of 18 months in a T2S context clearly would mean that technically it would be applied only after all CSDs have been migrated, but this only applies if none of the CSDs move their migration into a contingency wave. Moreover, it has been agreed that following the finalization of the migration a period of monitoring of the system should be applied to ensure the smooth operation prior to the introduction of any new change to the platform.

As a result, two-thirds of EU CSDs will be very busy testing for on-boarding CSDs during the next two years in the different migration waves (i.e., all CSDs will test, even those that are already migrated – testing with those that are about to migrate), which raises serious concerns from a settlement efficiency and financial stability perspective. This could risk the stability of a wide part of the European securities settlement infrastructure. The Committee is of the view that the settlement discipline measures, including the related reporting requirements to competent authorities, should be phased-in with a delay of at least 12 full months after the migration phase of T2S has been completed.

The RTS should be implemented in the proposed timeframe - but with a grace period of more than 6 months to allow market participants sufficient time to make the necessary adjustments to their processing.

The implementation of the proposed Buy-In regime, which would cater to an efficient handling of the process, may also require certain development costs. There is currently no electronic message system to allow for “straight-through-processing” of Buy-Ins within firms. The development of new messages in the context of T2S required extensive agreement amongst the standard-setting entities, i.e., SWIFT / ISO, and lasted significantly longer than the 18 months currently suggested in the draft RTS. The alternative, however, would be a manual “paper”-based process, which should be avoided as it is a manual process subject to errors and significant costs.

The elements which need to be taken into consideration include the following:

Impacts of CSDR on CSD participants (non-exhaustive)

* Prevention of settlement fails
	+ Adaptation of information contained in the allocations sent to investment firms by their professional clients (Article 2 (1))
	+ Adaptation of SLAs between investment firms and their clients to reflect new transmission timeframe of settlement details (Article 2(4))
	+ Adaptation of investment’s firms systems to adopt all mandatory matching fields required under the new RTS (Article 3 (3)) – requirement for a new field to be incorporated, a new ISO harmonised use is to be agreed and tested
	+ Adaptation of systems and internal processes to allow investment firms to monitor real time gross settlement (RTGS) throughout each business day (Article 3 (10))
* Cash settlement penalties
	+ Development of systems/processes for managing cash settlement penalties (pass on cash penalties to clients)
	+ Redrafting and re-negotiations of contracts with clients to cater to pass-on of charges
	+ Updating the message fields in daily fails reporting to incorporate the incurred settlement fines
* Buy-ins
	+ Development of systems/processes to facilitate the necessary exchange of information to support the buy-in process
	+ Renegotiation of existing contracts to cater to potential buy-in requirements and reimbursements
	+ Creation of new ISO-standard message types to support automated processing of buy-in notices

The example of T2S revealed that a number of messages had to be created from scratch, the full development cycle for which took about 18 months until they were available for use. If fewer messages would be created, this process could be shorter, however, in any case, there would need to be a defined market practice before the respective change request could be raised. Moreover, users of the messages (intermediaries, CSDs, CCPs) would also have to test the new messages accordingly.

Should the RTS need to enter into force earlier than suggested, CSDs and participants would have to invest in multiple discipline regimes for several markets in a very short period of time, which would lead to unnecessary expense and increased pressure during the T2S migration.

<ESMA\_QUESTION\_TS\_CSDR\_14>

##### What are your views on the proposed draft RTS on CSD authorisation (Chapter II of Annex II) and draft ITS on CSD authorisation (Chapter I of Annex VI)?

<ESMA\_QUESTION\_TS\_CSDR\_15>

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##### What are your views on the proposed draft RTS on CSD review and evaluation (Chapter III of Annex II) and draft ITS (Chapter II of Annex VI)?

<ESMA\_QUESTION\_TS\_CSDR\_16>

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##### What are your views on the proposed draft ITS on cooperation arrangements as included in Chapter III of Annex VI?

<ESMA\_QUESTION\_TS\_CSDR\_17>

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##### What are your views on the proposed draft RTS on CSD recognition (Chapter IV of Annex II)?

<ESMA\_QUESTION\_TS\_CSDR\_18>

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##### What are your views on the proposed approach regarding the determination of the most relevant currencies?

<ESMA\_QUESTION\_TS\_CSDR\_19>

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<ESMA\_QUESTION\_TS\_CSDR\_19>

##### What are your views on the proposed draft RTS on banking type of ancillary services (Chapter VI of Annex II) and draft ITS on banking type of ancillary services (Chapter IV of Annex VI)?

<ESMA\_QUESTION\_TS\_CSDR\_20>

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##### What are your views on the proposed draft RTS on CSD participations (Chapter II of Annex III)?

<ESMA\_QUESTION\_TS\_CSDR\_21>

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##### What are your views on the proposed draft RTS on CSD risk monitoring tools (Chapter III of Annex III)?

<ESMA\_QUESTION\_TS\_CSDR\_22>

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##### What are your views on the proposed draft RTS on CSD record keeping (Chapter IV of Annex III) and draft ITS on CSD record keeping (Annex VII)?

<ESMA\_QUESTION\_TS\_CSDR\_23>

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##### What are your views on the types of records to be retained by CSDs in relation to ancillary services as included in the Annex to the draft RTS on CSD Requirements (Annex III)? Please provide examples regarding the formats of the records to be retained by CSDs in relation to ancillary services.

<ESMA\_QUESTION\_TS\_CSDR\_25>

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##### What are your views on the proposed draft RTS on reconciliation measures included in Chapter V of Annex III?

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<ESMA\_QUESTION\_TS\_CSDR\_25>

##### Do you believe that the proposed reconciliation measures where other entities are involved in the reconciliation process for a certain securities issue within the meaning of Article 37(2) of CSDR are adequate? Please explain if you think that any of the proposed measures would not be applicable in the case of a specific entity. Please provide examples of any additional measures that would be relevant in the case of specific entities.

<ESMA\_QUESTION\_TS\_CSDR\_26>

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##### What are your views on the proposed reconciliation measures for corporate actions under Article 15 of the draft RTS included in Chapter V of Annex III?

<ESMA\_QUESTION\_TS\_CSDR\_27>

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##### What are your views on the proposed draft RTS on CSD operational risks included in Chapter VI of Annex III?

<ESMA\_QUESTION\_TS\_CSDR\_28>

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##### What are your views on the proposed draft RTS on CSD investment policy (Chapter VII of Annex III)?

<ESMA\_QUESTION\_TS\_CSDR\_29>

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##### What are your views on the proposed draft RTS on access (Chapters I-III of Annex IV) and draft ITS on access (Annex VIII)?

<ESMA\_QUESTION\_TS\_CSDR\_30>

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##### What are your views on the proposed draft RTS on CSD links as included in Chapter IV of Annex IV?

<ESMA\_QUESTION\_TS\_CSDR\_31>

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##### What are your views on the proposed draft RTS on internalised settlement (Annex V) and draft ITS on internalised settlement (Annex IX)?

<ESMA\_QUESTION\_TS\_CSDR\_32>

The Committee welcomes ESMA’s efforts on the draft RTS and ITS on internalised settlement. However, we would like to highlight a few remaining concerns.

1. **The requirement to report the value and number of failed transfer orders is not included in the mandate that is given to ESMA**

Art. 9.1 of Regulation 909/2014 provides that settlement internalisers report “*the aggregated volume and value of all securities transactions that they settle outside securities settlement systems.*”

However, Art. 2(j) of the draft RTS, provides that ESMA intends to ask settlement internalisers to also report:

* the number and value of failed transfer orders, knowing that a “transfer order” defined in Directive 98/26/EC includes cash and securities settlements through a securities settlement system; and
* a comparison of the settlement fails that occur as part of settlement internalisation and the settlement fails in the system.

The Committee believes this goes beyond the mandate given to ESMA under Art. 9.2 of Regulation 909/2014.

We therefore advocate the deletion of Art. 2(j) of the draft RTS, as the reporting in number and value of the transactions is already included in Articles 2(f) and 2(g). In addition, this requirement corresponds to none of the fields in the annexes of the draft ITS.

1. **The scope of the reporting obligation**

Art. 2.1.f).vii and Art. 2.1.g).iv provide that “others” need to be reported, respectively the type of financial instruments and type of securities transactions. Where a settlement internaliser doesn’t report “others”, it will be in breach of the RTS. It is therefore important that the items “others” are either deleted or replaced with more specific elements to be reported.

In addition, it should be made more specific that only securities issued in a Central Securities Depository operating in a Member State of the European Union should be subject to the reporting obligation, meaning namely that:

* All settlements related to on-exchange activity should be excluded; General Clearing Members provide the clearing service for their clients and receive netted instructions from the CCP containing multiple transactions. The resulting allocations to the respective client should not be considered internalised settlement;
* All settlements that are subsequent to corporate actions should be excluded; such “bookings” refer to the reflection of externally (by the CSD) performed activities and do not involve internalisation – those are mere “allocations” received from the CSD;
* All settlements that collateral management programs should be excluded as they don’t reflect any possible centralised settlement;
* Securities, which are not issued in a Central Securities Depository, shouldn’t be included in the declaration. This is for example the case of such as certain units of UCITs and AIFs after subscription.
* A settlement in the books of a CSD can correspond to transactions entered into by several clients since the CSD participant that settles at central level aggregates clients’ settlement instructions. For example, if one instruction in the SSS corresponds to 20 settlements in the books of the CSD participant, the latter should not be considered settlement internalisation.

The Committee is of the opinion that the proposed RTS would gain clarity if these points were made more specific.

1. **The content of the reporting obligation**
* Type of securities transactions

The identification of the type of transactions based on the suggested terms should be aligned to the ISO transaction codes that ESMA has already suggested in Articles of the settlement discipline RTS (Art. 2?). As ESMA rightly pointed out, these are not used in a consistent way. Custodian banks often don’t know the nature of the underlying transaction as currently proposed by ESMA in the RTS: identification per repurchase transaction, securities loan, collateral management, etc. is not possible as the custodian doesn’t have this information. To comply with the proposed standards, a market practice would have to be used and it would have to be ensured that the initiating parties to a settlement instruction fill the transaction type correctly.

* Types of clients

It is also unclear whether the split per client refers to the entity executing the trade or the settlement internaliser’s direct client. In case ESMA means the latter (the settlement internaliser’s client), the report won’t be accurate as the trades won’t be reported for the correct entity (custodians will report for instance as investment firm, who may be client, but the trade may actually be for a UCITS). If ESMA means the former (the entity executing the trade) the settlement internaliser will not have the documentation to classify this entity as the custodian will not necessarily have contractual relations with it.

* Split by country where the securities have been issued

The split of transfer orders per country where the securities have been issued would also require a systemic enhancement on settlement internalisers as clients’ instructions include the place of settlement and have no indication of the country where the securities have been issued.

* Aggregated volume and value

It is our understanding that based on the data and categorization proposed by ESMA, a transaction settled internally by a settlement internaliser will be double-counted in the report. For example, if client A buys 100 shares from client B and the settlement internaliser settles this, it will need to include 200 in its aggregate value reporting to reflect the trades settled for both client A and client B. We would like to ensure that this is ESMA’s intention.

1. **Format of the reports**

The template format of the reports that ESMA provided in the annexes are not sufficiently precise and leave fields open to interpretation by national authorities, as happened in the case of EMIR reporting. A standard template across all NCAs is critical to ensure one system is built and no unnecessary duplication of effort.

1. **Competent authority**

ESMA states that reports must be submitted by settlement internalisers established in the Union, their branches established in a third country and branches of third country entities operating in the Union, but it is not clear to us whether the reporting will be to the home State or host State authorities, i.e.:

* A US legal entity with an EU branch (London branch) settling Italian trades should report to whom? FCA, Bank of England or Italian competent authority?
* An EU legal entity with multiple branches should consolidate reporting to the competent authority of the legal entity (say FCA) or to the NCA of each and every branch?
1. **Time of implementation and submission of the first report to the competent authority**

The report is very detailed and would require systemic enhancements from the settlement internaliser in order to be able to produce the reports, so an additional concern is around timing of implementation.

The timeframe between the finalization of requirements and the first report submission won’t be enough to enable system enhancements, building of reports and testing to be ready for the first reporting as proposed. Ideally, the applicability of the reporting requirements should be aligned with the phase-in of the RTS on settlement discipline. With similar adjustments to be made in the use of the Transaction Types, institutions will be required to make significant changes to their processing. A phase-in period of 6 months should be considered.

1. **The original legislative content is to evaluate whether additional systemic risk results from internalised settlement compared to centralised settlement**

The term “systemic risk” is very broadly defined in the CPSS-IOSCO Principles for financial markets infrastructures, par. 2.2 p. 18. as “*the inability of one or more participants to perform as expected could cause other participants to be unable to meet their obligations when due*.”

Such subsequent inability to perform occurs both in centralised settlement and in internalised settlement, e.g., a purchaser doesn’t receive the purchased securities and therefore can’t deliver in a subsequent sale.

We point out that:

* Where a settlement occurs centrally, the cash settlement and the securities settlement occur in 2 distinct institutions (CSD and Central or commercial bank)
* Where the settlement occurs internalised, the cash and securities settlement occur in the books of a same entity.

Therefore, when cash is not paid to the settlement internaliser, securities are not delivered and vice versa. As a result, settlement risk that is incurred is effectively the same as in centralised settlement (impacting subsequent sales). However, in no case can counterparty risk occur, i.e., the risk that the securities are delivered without the cash being paid, putting the counterparties at risk for the nominal value of the transaction.

1. **The aggregate reports on internalised settlements will result in an incomplete image of the internalised settlements that take place in reality.**

The definition of “settlement internaliser” in Regulation 909/2014 refers to settlements that occur outside a securities settlement system. As a result, settlements that occur in a central securities depository in securities for which that central securities depository doesn’t fulfil the central custody function fall outside the reporting obligation, including where the cash payments settle in cash accounts opened in the books of a commercial bank.

As “transfer orders” as defined in art. 2(i) of Directive 98/26/EC include cash settlements in the books of commercial banks, the reports under the draft RTS and the draft ITS on internalised settlement will give an incomplete picture of the aggregate of internalised settlements that take place in the EU because a large part of the institutions that operate internalised settlements fall outside the scope of the reporting obligation.

<ESMA\_QUESTION\_TS\_CSDR\_32>

1. The members of the Association of Global Custodians are: BNY Mellon; Brown Brothers Harriman & Co; Citibank, N.A.; Deutsche Bank; HSBC Securities Services; JP Morgan; Northern Trust; RBC Investor & Treasury Services; Skandinaviska Enskilda Banken; Standard Chartered Bank; and State Street Bank and Trust Company. [↑](#footnote-ref-2)