Association des Banques et Banquiers, Luxembourg
The Luxembourg Bankers' Association
Luxemburger Bankenvereinigung

ABBL RESPONSE TO ESMA DISCUSSION PAPER ON DRAFT TECHNICAL STANDARDS FOR THE REGULATION ON IMPROVING SECURITIES SETTLEMENT IN THE EUROPEAN UNION AND ON CENTRAL SECURITIES DEPOSITORIES (CSD)

Information about the ABBL (Luxembourg Bankers' Association): ***ABBL ID number in the COM Register of interest representatives:*** 3505006282-58	
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General Comments

The Luxembourg Bankers' Association[1] (ABBL) welcomes the opportunity to comment on the ESMA Discussion Paper on Draft Technical Standards for the CSD Regulation (CSDR).

From a banking perspective, the creation of a settlement discipline regime that applies to all models of trading, clearing and settlement will be extremely challenging. As pointed out in the European Banking Federation response, the benefits may as well not be impressive or may even be counterproductive (through an excessively rigid framework) if one takes into account the ECSDA 2012 survey only 0.5% of transactions fails to settle on the intended date[2]. Unlike T+2, which only affects trading on a regulated market, settlement discipline affects all settlements, regardless of how a security is traded and whether it is cleared or not.

[1] 1 The Luxembourg Bankers' Association (ABBL) is the professional organisation representing the majority of The ABBL counts amongst its members' universal banks, covered bonds issuing banks, public banks, other professionals of the financial sector (PSF), financial service providers and ancillary service providers to the financial industry.

[2] ECSDA 2012 Statistical Exercise on Matching and Settlement Efficiency of September 2012

This is deeply problematic. For example: custodians hold assets for clients and their responsibility is to execute clients' instruction and to deliver securities as required to the CSD for settlement; most of the time this is instructed by the client's broker. In the end, custodians have no legal power to 'buy-in' a client should that client fail to deliver an asset or have it available for settlement. Shall they then take responsibility for this? It would be counterproductive should ESMA create a regime where the liability falls on custodians if the latter have no means to pass this directly through to their ultimate clients. The consequences may be an increase in costs for clients as custodians will have to take this new legal risk in to account, or it may result in clients being denied access to CSDs (market…) and eventually push clients to seek out non-EU custodians because of these higher costs.

Additional problems arise when the actual process behind a buy-in is considered. For example, what exactly constitutes the beginning of the buy-in process – is it the notification that a buy-in procedure has begun, or is it a notice of settlement failure, when sent, received, by whom? At least from the outset it is certain that some delays should be allowed for a notice to travel through the intermediary chain, taking into account the possibility of a dispute somewhere in the chain.

Response to the Consultation Paper

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?

The ABBL notes that the shortening of the settlement cycle accompanied by the focus on timely settlement of transactions will force investment firms and their professional clients to use efficient solutions. At the same time, even if T2S will force the use of ISO20022 for a large part of the market, the scope of this system is "only" a subset of the CSD-R. The Association therefore invites ESMA to take into account other tools.

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.

If it is clear that increased reliance on STP is a plus in terms of efficiency and risk management, the ABBL would be opposed to a "ban" of manual intervention, notably to take into account circumstances such as: messaging corrections, processing of specific corporate actions or primary market transactions. Manual process may, under such circumstances, even improve the accuracy or timeliness of the settlement in the best interest of the wider market. To summarise: STP processes should be facilitated/incentivised by the regulation but manual process cannot be outlawed.

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

Automated STP processes throughout the securities value chain are in place in several markets and are supported by different standards (e.g. FIX, ISO). Highly automated STP securities settlement is today mainly based on the globally used ISO 15022 MT messages, but again, knowing that the T2S platform will require ISO 20022, CSD-R may be a tool to help markets move in that direction. This being said, in light of the difficulties to move from 15022 to 2022, casting into stone the requirement for a specific language may in the future not be the optimal choice.

Nevertheless, the ABBL would like to remind ESMA that these level II rules are presented in the context of a CSD regulation applicable to CSDs and indirectly to their participants, where in this case these rules are for all stakeholders, which implies that forcing 20022 across the entire chain via a delegated act may be one step too far. Furthermore, the standard will be applicable in the T2S area, not in the rest of Member States.

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?

This is current market practice. In addition, T2S will introduce a matching regime. The ABBL thus believes that pre-settlement matching could be made compulsory with some specific situations to bear in mind, for example:

(a) When instructions have already been matched by a trading venue or a CCP and are received by the CSD via a trade feed;

(b) In case of corporate actions processing;

(c) Or other exceptional transfers.

(d) Free of payment (FoP) transfers among securities accounts managed by the same CSD participant.

However the ABBL believes that mandating the use of matching fields would not bring substantial benefits in terms of reducing the level of settlement fails, while being a requirement which would go beyond the delegated regulation mandate.

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?

In order to encourage early input of settlement instructions, the association supports the offering of a hold/release mechanism combined with bilateral cancellation based on the T2S rules. However, other measures proposed may, if introduced, render the whole system more complex and cumbersome and not necessarily more efficient. The ABBL would prefer to build a system based on incentives rather than punitive measures, unless in exceptional cases.

In any event the ABBL would not favour tariff solution to promote early settlement that might be imposed by form of legislation.

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

Yes, alignment with the T2S cycle is a must and ensures maximum efficiency from an operational process perspective.

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

The ABBL feels that in this case the delegated regulation will go too far. Again, T2S will already set new market standards.

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.

In its own time CESR-ESCB Recommendation 5 for SSS proposed that such arrangements should be left to each CSD and its participants, which seems to be still endorsed.

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.

While the ABBL generally supports reporting, in order to be efficient it would be better to align frequency on what is strictly relevant and necessary for market supervision. The system proposed may work for indirect clearing, but the ABBL wonders if it would be relevant for directly connected parties.

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

The ABBL fears that this may imply sending unnecessary data with an increase in associated costs. The Association would prefer to let participants access regular reports on their individual level of settlement fails; an option that should be defined on a contractual basis.

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?

The CSD-R text is clear and in the ABBL's view does not impose any implementing standard: "*These reports […] shall be made public by CSDs in an aggregated and annonymised form on an annual basis".* Which appears to be obvious since the CSD may not be in a position to know "who's fault it is".

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

The ABBL has the feeling that this information flow will be rather expensive and of limited usefulness. A monthly report may satisfy all parties and be more cost efficient.

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?

The ABBL believes that buy-in should be used at last resort and instead of focusing on incentives to settle in time would be a better approach.

The fact that assets are listed or not may trigger some additional extension.

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?

As a general rule, because of the need to align with the new EU regulatory environment, the ABBL would support the concept of an alignment between buy-in procedure managed by a CCP or a trading venue and CSDs.

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

There may be additional cases, but a buy-in can be considered impossible under the following scenarios: either for illiquid or low liquidity instruments, a mandatory buy-in could have a negative impact on the market, or during exceptional times, e.g. on-going corporate actions.

In addition, the ABBL does not favour a technical standard on the coordination of multiple buy-ins on the same financial instruments.

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

3 principal situations could be envisaged: in the case of repo transactions where the execution date and ISD have the same dates, for FoP transactions and for some OTC transactions.

Specifically in the case of a repo trade securities are the collateral part to secure the cash financing. Therefore, the opening leg of a repo contract should not lead to a buy-in. The transaction simply does not take place.

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

Yes, we agree.

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

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

Q18&Q19: Criteria should be put at a relatively high level as the suspension of a CSD participant might have severe market consequences, particularly if this suspension is triggered automatically upon reaching a set threshold. There is thus the need for only excluding under a major stress scenario and probably based on information of the national competent authority, as it might have far-reaching impacts on the participant and its clients. The impact of a CSD removing a participant not only will have a direct impact on the CSD relation but it is likely to mean impacts at CCP and trading venues as well. This calls for a balanced approach.

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.

In many cases there are no links between CCP – counterparties – Participants - and CSDs. This may therefore raise more issues than necessary, notably as to who is responsible for the buy-in?

In practice, the proposed approach (68) would impose each counterparty to create an account at CSD level, segregated from its regular account, as envisaged under level 2 approach. This will only amount to the creation of thousands of accounts, if not more, which would dramatically complexify the structure and increase counterparty risks.

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

The ABBL considers the principle of quarterly reporting of internalised settlement to be the maximum frequency of reporting. In addition, the delay of 5 days may be short, notably given

the nature of the information: half of the transactions will be more than 45 days. The Association thus sees no urgency in the process.

The ABBL considers that the following questions are CSD specific, and will therefore concentrate on high level considerations".

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.

The process appears to be, on the one hand, complex and demanding for already licenced entities and in addition imposes or may impose extensive amounts of information to different counterparties (often in duplication readily in the hands of the competent authority or published by the CSD); information that is not necessarily presented in the same manner and with no real added value.

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.

The approach seems to be 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?

Although the ABBL understands the need to avoid exposures to unrelated activities, the purpose of restricting certain sectors is not self-evident and the efficiency of that approach may be at least debatable. CSDs are institutions that have existed for a long time and that have in the course of their activities developed market services: there may be no reasons to exit these as long as their impact is duly managed and considered.

In addition, CSDs with a banking licence should probably be fully exempted from these requirements as they are subject to the credit exposure and operational risk rules for capital adequacy purposes. The ABBL invites ESMA to reconsider the restrictions envisaged under 97 and 98.

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.

Even if under a new set of rules to help mitigate systemic risk, NCA shall go for on-going supervision instead of ad hoc, the ABBL has the feeling that this process will overburden these NCA with data of low value when put in relation to the CSD obligation to inform NCA without undue delay of material changes affecting their condition to quote article 16.3 of the CSD-R.

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

Yes, however, the ABBL questions the treatment of EU CSDs active outside the EU. Will they be on a same level playing field?

The ABBL understands the proposed recognition procedure vis-à-vis third countries CSDs, but questions how will continuous compliance be ensured, how will supervisory equivalence be followed up and comply with EU standards.

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?

The depiction presented appears appropriate. This being said, the ABBL would like to remind ESMA that besides specific rules targeted at CSDs, other national and EU regulation will also apply. Duplications and inconsistencies between different sets of requirements should be avoided, therefore, CSD-R specific rules should ideally be designed so that they apply only to fill the potential gaps left open by other regulations, as the CRD IV for CSDs with banking licence.

As to the audit reports, although they shall be first addressed to the management of the CSD, they may have informative value for risk committees… however the issue would then be to strike a balance between high and low priority events. With that aim in mind the ABBL points to the level one requirement which mandates ESMA to specify the "circumstances in which it would be appropriate (...) to share audit findings with the user committee", not mandate this requirement.

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?

The ABBL is uncertain if this approach is not confusing the role of Trade Repositories with CSDs. The Association therefore does not support this approach.

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?

At this moment LEI are under deployment and mostly in the EU for OTC derivative trades, which is not a core area for CSDs. In terms of availability of data, the Association considers that this should be on an ad hoc basis once a demand arises from an NCA.

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

These are the minimal areas to cover, the ABBL thinks that AML, KYC or other compliance or even commercial risks may be part of the concerns.

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.

There is a need to strike a compromise between allowing the time for a robust analysis and evaluation and, on the other, the commercial needs. The Association considers that the proposal should in most cases be satisfactory but that exceptions may occur.

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

No, as underlined its costs far outweigh the potential benefits.

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

No

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?

Double entry accounting should be sufficient to offer a robust solution at a reasonable cost.

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

The standards should follow the CPSS-IOSCO PFMI 17 to ensure global coherence (taking into account the 3rd country impact on EU markets).

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.

The most important aspect in the ABBL's view is that the approach is in line with the CPSS-IOSCO standards, which appears to be the case in many areas, although some clarification may usefully be introduced for example under 154. This should not be interpreted the need to apply a specific tool or IT system if current procedures are satisfactory.

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

Yes

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

The ABBL thinks that what is important is that systems are aligned with market requirements and are updated on a reasonable basis to cope with new products, new IT tools…yet this is highly dependent on each CSD organisation and internal planning for upgrades. Assuming a mandatory one-year review will add costs and constraints, the Association questions the value added in terms of efficiency.

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?
CSDs should indeed have backup and fall back plans ready to be operational in a short time period. The issue is how to draw a line between realistic demand and absolute security. To make an analogy with road safety: if the speed limit is at 0 then there are no more accidents, but nobody is moving any longer.

Regarding BCP planning in the case of smaller countries, the impact of distinct locations may be complex to solve, to say the least. Perhaps separate sites are enough; a requirement in terms of kilometres is overshooting the target, unless it would entail to allow secondary sites cross-border.

Finally, with regards to the maximum recovery time of 2-hours, this should be target for critical functions in general, with enhanced flexibility for non-critical functions. And should also take into account the time during the day in which the incident occurs (within or out of the operating hours might need different approaches).

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?
At this stage what is probably more important is the concept rather than the fine print. Understanding the dynamic of risk transmission may improve the systemic risk position of CSDs, however that should not be an end in itself.

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

No, CSDs with banking services are subject to a more comprehensive regulatory framework (CRD/CRR…). As a consequence, the RTS should only apply to the non-Banking CSDs.

Q42: Should ESMA consider other elements to define highly liquid financial instruments, 'prompt access' and concentration limits? If so, which, and why?
No, except that duration does not in itself translate into high or low liquidity. The Association notes that CSDs with banking services (and more robust risk management frameworks) are under the Central Bank eligibility framework, which is wider.

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
Q44: Do you find the procedures mentioned above 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?
Q46: Do you agree that DvP settlement through CSD links is practical and feasible in each of the cases mentioned above? If not explain why and what cases you would envisage.
Yes to questions 44 to 46.

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.
It is not enough. There should at least be consideration for elements like attribution of securities number, or compliance/AML/KYC risks.

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.

Generally speaking, the delays are appropriate for most cases. However, the concerns may lie with more specific issues/issuers where flexibility should be offered to allow due time for consideration of each specific case.

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

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

Yes

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?

As in the above cases, consideration for compliance, AML, KYC concerns and others should not be excluded from the outset.

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.

Delays may generally be appropriate, balancing the commercial requirements with the time for “risk assessment”. However, there may be instances where the delays should be longer.

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

Yes

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?

The Association believes that the consultation document references appropriate areas. Consideration should also be given to CSDs with banking services which by default should abide by the banking rules.