

# Reply form for the Technical Advice under the CSDR





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 - D Technical Advice under the CSDR, 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:

- i. use this form and send your responses in Word format;
- ii. do not remove the tags of type <ESMA\_QUESTION\_TA\_CSDR\_1> i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- iii. 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:

- i. if they respond to the question stated;
- ii. contain a clear rationale, including on any related costs and benefits; and
- iii. 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\_TA\_CSDR \_ESMA\_REPLYFORM or ESMA\_CE\_AIFMD\_ESMA\_ANNEX1

To help you navigate this document more easily, bookmarks are available in "Navigation Pane" for Word 2010 and in "Document Map" for Word 2007.

Responses must reach us by 19 February 2015.

All contributions should be submitted online at <u>www.esma.europa.eu</u> 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 <u>www.esma.europa.eu</u> under the heading 'Disclaimer'.



### General information about respondent

| Are you representing an associa- | AFTI (Association Française des Professionnels de Titres) |
|----------------------------------|---|
| tion?                            |   |
| Activity:                        | Post trade services                                       |
| Country/Region                   | France  |



#### Q1: What are your views on the proposed basis for the cash penalty calculation?

#### <ESMA\_QUESTION\_TA\_CSDR\_1>

**Association Française des Professionnels des Titres** - AFTI - (French Association of Securities Professionals) is the leading Association in France and in the European Union representing the post-trade businesses. AFTI gathers more than 100 members all market players in the posttrade industry: custodians/depositaries, investment firms, market infrastructures, issuers.

AFTI's members are deeply in the settlement and clearing process and are therefore within the scope of CSD regulation. However given the activities of AFTI's members, we have chosen to reply only to the items relevant to our members. The answer was elaborated in close relationship with the "Association des Marchés Financiers" (AMAFI) and AFTI fully supports its responses to the Consultation Paper.

#### Preliminary remark

When reading the Commission mandates we understand that the Commission speaks about transactions rather than settlement instructions:

.... In particular, any participant to a securities settlement system operated by a CSD, party to a transaction that fails to deliver the relevant financial instruments on the agreed settlement date will be subject to cash penalties... (1.1 Scope)

... (d) how to adapt the parameters for the calculation of cash penalties in the context of a chain of interdependent transactions and whether there are cases where this would not be possible (e.g. the chain would not be visible).

(3.2 Content of the technical advice)

Such wording may lead to believe that the participant to a SSS is also the party which agreed the transaction. In most of the cases such assertion is just false.

Therefore we warmly welcome the effort made by ESMA to distinguish a transaction and the different settlements the conclusion of the former will introduce. By defining the settlement instruction and using this terminology, ESMA recognizes that at the CSD's level it is no more about parties engaged by the transactions but only about entities in charge of the settlement of a transaction concluded upstream. We note also the use of "party/ counterparty" for the "transaction level by opposition to "participants" for the settlement level.

#### Answer to Q1

#### On the reference price

We agree the idea of a single reference price commonly used by all CSDs regulated by the CSDR rather than a calculation based on the amount of the instruction.

However, we believe that some precisions should be given by ESMA:

How will the harmonization be managed at a European level? Would there be an official provider?



- What will be the "value date" of the reference price? Will it for each day the closing price of the previous business day? The closing price of the ISD? How will we deal for securities for which we miss either a price and/or a recent transaction?

We advocate for a central entity mandated by ESMA to provide the prices for the security: in our view it will give clarity and transparency to the global process, avoid leading the way to interpretation

#### On partial deliveries

The proposed set-up avoids any undue penalty and therefore is a fair way to handle the opt-out issue AFTI raised in its documents. However, as detailed in our answer on question 6 of the CP on the Draft RTS, such mechanism is not built to penalize bad behaviors.

We agree on the fact that if the opt-out has been activated by the failing participant itself then it should be penalized for the whole quantity.

#### <ESMA\_QUESTION\_TA\_CSDR\_1>

Q2: What are your views on the proposed approach regarding the categories of financial instruments and the penalty rates? In particular, do you consider that these penalty rates could dis-incentivise trading in small caps? Please provide evidence to support your views.

#### <ESMA\_QUESTION\_TA\_CSDR\_2>

#### Categories of transactions

We agree that the penalty regime does not make any distinction regarding the type of transaction.

#### Penalty rates

The regime as designed doesn't exist today and is based on features that do not allow as easy assessment of its financial impacts. None can easily take its current failing settlements, apply to them a penalty using a non-defined price reference without knowing the overall context (would it receive a full indemnification ...).

Indeed while a net and a gross models should normally give the same result at the end, man should recall ESMA that the regime as built today will not be able to ensure a full indemnification in all circumstances and thus rates that may be acceptable in a net model will lead to huge impacts should they be applied instruction per instruction.

The industry may only rely on surveys as the one conducted by ECSDA in 2013 to try to get an approximate financial value of the future penalties. This will definitively not allow AFTI to say if a 0.25bp for government bonds will be more correct than a 0.20bp for example.

Therefore and in the line of our answer to question 14 for the draft RTS, we strongly believe:

- That there should be a phase in period during which the calculation will be processed but no penalties would be paid

- And that the final rates will be stated using the experience of this "no-charge" period

Finally we would like to share with ESMA the French experience. No need to recall that the French CSD applies a penalty regime since quite 30 years.



The French penalty regime is:

- Based on a net position (rather than a gross model)
- With a fixed fee (not an ad valorem)

Despite such "restricted" features, the settlement rate in due date (on ISD) is for the French market near 99%.

We can conclude that very high penalty rates are not a pre-requisite to get high settlement rates since we are deeply convinced that it can't be viewed as another example of a "French exemption"

#### Asset type and liquidity of the financial instruments

The ISO classification: 10962 (Classification of Financial Instruments (CFI code)) does not support the separate category "corporate bonds and therefore we do not see how the approach could be differentiated for the corporate bonds

For the Fixed Income products, the settlement Discipline framework must not inflict irreparable damage on the European Fixed Income markets. Those are wholesale markets trading on large amounts mainly on an OTC basis. The liquidity is guaranteed by market makers and settlement discipline may avoid penalizing the players that aim to animate the market

#### The recommended approach

We would appreciate some confirmation of our understanding of the following paragraph:

37. In order to determine the rate that should be applied for the penalties rate per asset type/liquidity, it is important to note 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. Therefore it is not designed to replicate exactly the loss incurred by the failed participant, or the gains achieved by the failing participant. The purpose of the penalties is to be sufficiently deterrent and to introduce the desired incentives to prevent and reduce settlement fails. It also is an add-on to any claim in compensation that the failed party may contractually have over the failing counterparty.

Our understanding is that the compensation referred to is between the parties of the transaction and in no case between participants of the settlement since there is no contractual arrangement between them. Should the system fail for any reason to immunize participants in the middle of the chain, there will be no contractual rationale as well as logical one for the participant to ask for compensation to another one.

#### <ESMA\_QUESTION\_TA\_CSDR\_2>

Q3: What are your views on the proposed approach regarding the increase and reduction of the basic penalty amount?

<ESMA\_QUESTION\_TA\_CSDR\_3>



We agree with ESMA in its proposed approach to start without any increase / decrease for the purpose of *"taking into account of the actual behavior of non-compliant participants (eg .repeated non-compliant behavior)"* (point 3.1 of the mandate, page 34 of the CP).

We also support the idea detailed in point 60 page 16:

ESMA understands that situation and proposes that in the limited circumstance where settlement cannot be performed for reasons that are independent from any of the participants or the CSD, the penalty would not be charged. In order to achieve that exception, it should be possible to reduce the amount of the penalty to zero. Examples of these occurrences may be a suspension of the instrument from trading and settlement due to reconciliation issues, specific corporate actions which imply the instrument no longer exists, or technical impossibilities at the CSD level. <ESMA\_QUESTION\_TA\_CSDR\_3>

### Q4: What are your views on the proposed approach regarding the cash penalties in the context of chains of interdependent transactions?

#### <ESMA\_QUESTION\_TA\_CSDR\_4>

We welcome the fact that ESMA has built a regime based on the fundamental principle that a non-defaulter should be immunized.

Indeed to be acceptable and understandable by anyone the penalty regime should firstly be fair. Undue penalties will leave room to claims from participants and also from their clients and will lead to endless discussions and difficulties to pass on the fines. Even a real defaulter will use the default of the regime to avoid the penalties.

The per instruction model having been chosen by ESMA, the full redistribution of the penalty perceived is obviously needed but in fact not sufficient to achieve the objective of a fair regime.

As described in our response to question 6 to our response to the Technical Standards Consultation, the regime should take into account not only the opt-out case but also the partial settlements' process that is currently mostly triggered only if the available quantity is above a threshold (a minimum size unit).

Once again we believe that the best manner to handle chains of interdependent transactions which at the CSD level will give chains of independent settlement instructions is the use of a penalty regime based on net a position since the CSD can't retrieve this chain of interdependent transactions. This point is even more accurate in case of cross-CSDs settlements. <ESMA\_QUESTION\_TA\_CSDR\_4>

### Q5: Do you agree with the proposed frequency of one year for the assessment of the substantial importance of a CSD in another Member State?

<ESMA\_QUESTION\_TA\_CSDR\_5> Not relevant for AFTI <ESMA\_QUESTION\_TA\_CSDR\_5>

#### Q6: What are your views on the proposed indicators?

<ESMA\_QUESTION\_TA\_CSDR\_6> Not relevant for AFTI <ESMA\_QUESTION\_TA\_CSDR\_6>



#### Q7: What are your views on the proposed thresholds?

<ESMA\_QUESTION\_TA\_CSDR\_7> Not relevant for AFTI <ESMA\_QUESTION\_TA\_CSDR\_7>

## Q8: Do you believe that the proposed indicators and thresholds are relevant in the case of government bonds? If not, please provide details and arguments.

<ESMA\_QUESTION\_TA\_CSDR\_8> Not relevant for AFTI <ESMA\_QUESTION\_TA\_CSDR\_8>