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| 18 December 2014 |

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| Reply form for the  Technical Advice under the CSDR |
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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 - 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:

1. use this form and send your responses in Word format;
2. 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
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\_ 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 [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

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| Are you representing an association? | Yes |
| Activity: | Central Securities Depository |
| Country/Region | Europe |

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

<ESMA\_QUESTION\_TA\_CSDR\_1>

ECSDA supports the mark-to-market approach proposed by ESMA, provided that:

* there are clear rules on which reference price should be used and;
* CSDs are able to access a reliable source for such prices.

It is very important that the ESMA technical advice clearly states whether all EU CSDs are expected to use the same references prices (and thus the same source of prices) or not.

Providers of market data compete with one another to provide the “best prices”, which they source from various trading venues and market participants. As soon as two CSDs use a different provider for obtaining reference prices, it is impossible to guarantee that they will always have the same reference prices. This means that ESMA must choose between two options:

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|  | **Option 1: All EU CSDs use a single source for reference prices to ensure that penalty amounts are always the same across CSDs.** | **Option 2: CSDs can choose any provider of market data. Penalty amounts might occasionally differ from one CSD to another.** |
| ***Pros*** | * No competitive distortions (level playing field) among CSDs as regards penalty levels | * Possibility for CSDs to appoint a provider of their choice, competition among providers |
| ***Cons*** | * Need for CSDs to agree on a single provider, involving potentially a complex tender procedure and the negotiation of contractual conditions with the selected provider | * Potential risk of competitive distortions, especially in relation to cross-CSD settlement |

Irrespective of the option chosen by ESMA, ECSDA is concerned that reference prices might sometimes be difficult to obtain. In particular, we are not convinced that the “primary market” can always be identified for financial instruments included in the scope of the CSDR settlement discipline regime. ETFs, for instance, are often listed on multiple markets do not necessarily have a primary market. The “primary market” is also likely to be difficult if not impossible to identify for financial instruments admitted to trading on one or more OTFs.

Moreover, the ESMA technical advice should clarify whether the penalty fee imposed on a failed instruction that is pending for multiple days should be calculated based on a single reference price (determined at the end of ISD) or whether a different reference price should be used for each day when the instruction fails. The first option would have the advantage of being less complex and costly to implement.

Finally, ECSDA disagrees with the ESMA approach for partial deliveries and believes that it will be overly complex to implement, if not outright impossible. We recommend an alternative approach, whereby (a) the penalty would apply to the whole instruction, in case the delivering party rejects partial settlement, and (b) the whole instruction would be exempt from penalties, in case the receiving party rejects partial settlement. Such an approach will be easier to implement and would have the additional benefit of incentivising all parties to opt for partial settlement, as they would otherwise risk being penalised or not being compensated for the whole transaction.

<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>

ECSDA welcomes the fact that ESMA takes into account the borrowing costs and liquidity when specifying the penalty rates for different categories of financial instruments. However, we are concerned that the proposed categories of instruments are not consistent with the categories used by ESMA to distinguish different asset types for the purpose of fails reporting in the draft RTS on settlement discipline (see our answer to question 5 of the Consultation Paper on the draft RTS). ECSDA believes that, to be meaningful, fails reporting should reflect the categories of financial instruments subject to different penalty rates.

In particular, the distinction between government bonds and corporate bonds in relation to penalty rates is not consistent with the use of a single category for debt instruments under art.4(2)(d)(ii) of the draft RTS on settlement discipline. ECSDA is not convinced that a different rate should apply for corporate bonds and government bonds, and we believe that an impact assessment is lacking to justify a different treatment.

Based on data collected from 17 CSDs, ECSDA attempted to assess the market impact of the proposed penalty framework. Some inconsistencies in the data were inevitable given the tight deadline and the lack of clarity as regards some of the measures proposed by ESMA in the draft standards and technical advice. The figures should thus be interpreted with caution. We are nevertheless confident that they can be used as rough indications of the actual impact of the proposed measures. The biggest difficulty faced by CSDs taking part in the exercise was to define the appropriate scope of instructions to be included in the fails data. Since CSDs are currently mostly not able to identify whether a financial instrument is “*admitted to trading on a trading venue*” (i.e. not only admitted to trading on a regulated markets, but also on MTFs or OTFs), the data provided often includes all instructions (in all financial instruments) processed by the CSD.

Keeping these limitations in mind, we estimated the value of late settlement penalties that would have to be collected and redistributed by CSDs on a monthly basis, if the categories and related rates put forward by ESMA were maintained. It should be noted that the figures were calculated on a gross basis, without taking into account the possibility for CSDs to net penalty payments per participant at the end of the month. The actual payments to be made at the end of the month based on the rules proposed by ESMA are therefore likely to be lower. On the other hand, we have assumed that no further penalties are due after ISD+4, once the buy-in is triggered, which may lead, to a certain extent, to an underestimation of the real amount of the penalties to be collected.

According to November 2014 data, the accumulated gross late settlement penalties to be collected by the 17 CSDs would have amounted to over EUR 183 million or around EUR 9 million a day. Assuming that the month of November is representative, this translates into yearly gross late settlement penalties of close to EUR 2.2 billion.

While the two ICSDs hold the largest share of late settlement fines to be collected (75%), the difference is less striking than for buy-ins. Excluding the two ICSDs, the remaining CSDs would on average still each account for more than EUR 3 million per month. Among these CSDs, figures range between very close to 0 and EUR 15 million per month, and only 5 CSDs would have collected less than EUR 100,000 worth of penalties.

In order to assess whether the different types of penalty rates suggested by ESMA were meaningful, ECSDA asked CSDs for fail rates per asset type, but not all CSDs were able to provide settlement fail rates based on the asset categories provided by ESMA. In particular, it was not possible to distinguish the fail rate of "*SME growth market shares*" from other equities.

Based on the sample and with only few exceptions, equities and ETFs combined seem to display the highest fail rate, compared to other asset categories - in most cases, at least 2-3 times the fail rate for debt instruments. Only 3 CSDs provided separate figures for ETFs, which suggest that the fail rate for ETFs is even higher than that of equities. Debt instruments seem to have the lowest fail rate relative to other instruments. In most cases, a distinction between government and corporate bonds was however not possible. Whenever the distinction was made, the rates were broadly aligned - with a few exceptions where fail rates on corporate bonds were significantly higher (however possibly due to a few significant outliers).

The fail rate for all other instruments including invesment funds was in general relatively high as compared to debt instruments and similar to the rate of equities and ETFs. This however differs quite substantially across CSDs and seems to depend very much on the specific instruments that each CSD settles.

Most CSDs did not provide numbers for fails due to a lack of cash. In the few cases where this data was available, their value accounted for 5-15 % of the total number of fails.

In general, it is also interesting to note that the relative weight of the instruments settled differs significantly across CSDs/markets. While some CSDs settle mainly equities, other CSDs primarily settle debt instruments (mainly government bonds). This obviously has an impact on the amount of the penalties collected, given that the penalty rate is significantly lower for government bonds in the ESMA proposal.

Based on the figures, the proposed rates would lead to an average effective penalty rate over all instruments and CSDs of 0.79 basis points. This rate differs however significantly across CSDs, ranging between close to 1 bp (if mainly equities and others) and only slightly above 0.3 bp (if mainly government bonds).

<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>

ECSDA agrees with ESMA that no increases or decreases of the penalty rate should be foreseen at this stage. As explained in our response to the ESMA Discussion Paper on 22 May 2014, a system involving increases and/or decreases would make the implementation of the penalty mechanism very complex and would lead to various problems in relation to the "passing on" of penalties.

We also welcome ESMA’s proposal to allow CSDs, in limited circumstances and on an ad hoc basis, to decrease the penalty rate to zero, e.g. if a fail is caused by circumstances outside the control of the failing participant. That said, in line with the T2S AG response to the ESMA Consultation, we think that it is appropriate to foresee a more general rule whereby penalties would be set to zero for all fails which are not due to a lack of cash or of securities, in line with the definition of “fails” in the Level 1 CSDR. Exceptions to this rule need to be explicitly mentioned in the Level 1 CSDR or the Level 2 technical standards, for example on hold instructions and instructions sent after the intended settlement date.

<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>

ECSDA shares ESMA’s view that the "passing on" of penalties should be sufficient to address issues related to chains of interdependent transactions, whether identifiable by the CSD or not. We thus agree that, for the sake of simplicity of the penalty mechanism, the parameters of penalty calculation should not be changed in cases of chains of interdependent transactions.

<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>

Yes.

<ESMA\_QUESTION\_TA\_CSDR\_5>

Q6: What are your views on the proposed indicators?

<ESMA\_QUESTION\_TA\_CSDR\_6>

ECSDA has serious doubts about the validity of ESMA's indicators and remains convinced, in line with the approach taken in article 23 of the Level 1 CSDR, that the notion of “*provision of services*” should be limited to cases where the CSD has set up a branch in another Member State or provides notary and/or central maintenance services in that country, i.e. excluding the settlement service.

We thus disagree with Section 3.5 of the ESMA Consultation Paper on technical advice (p.22-24) and believe that the "settlement indicator" is not appropriate.

We believe that consistency with the Level 1 CSDR is all the more important since the text of art.24(4) of the CSDR approved by COREPER (Council representatives) prior to the finalisation of the text by lawyer-linguists clearly stated that, *"when taking into account the situation of the securities markets in the host Member State, the activities of a CSD that has established a branch have become of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State, the home and host competent and relevant authorities shall establish cooperation arrangements for the supervision of the activities of that CSD in the host Member State."* Despite the adoption of a different wording in the published text of the CSDR, we believe that the intention of the EU legislator was clearly to limit the cases of "systemic importance" to CSDs having a branch in a host Member State, and not to cover all other cases of cross-border service provision.

Irrespective of the consistency problem with the Level 1 text, ECSDA further strongly disagrees with ESMA’s statement in paragraph 86 of the Consultation Paper (p.23-24) that *“participants of the host Member State would be an adequate proxy for investors”.* There are many cases, today, of CSD participants holding securities on behalf of investors established in different (EU or non-EU) countries than the country where the participant itself is established, sometimes to a very large extent. Furthermore, in addition to be contradicted by today’s reality in many CSDs, this statement goes against the primary objective of the CSDR and the EU Single Market, which is precisely to further encourage and facilitate the use by investors of intermediaries (CSD participants) established in a different EU jurisdiction than their own.

We recognise the difficulty of establishing a workable threshold in those cases where CSDs have no information on the country of establishment of their participant’s clients, but we think that this limitation should not be a reason to use an inaccurate and obsolete criterion that will not accommodate the natural evolution of the EU single market.

As a result, ECSDA thinks that the indicators included in Section 3.4 of the Consultation Paper as regards the central maintenance service (p.20-22) are not adequate and should be reviewed. The country of establishment of CSD participants is not a good indicator and it is perfectly possible for a foreign intermediary (CSD participant) to hold securities primarily for domestic end investors, and vice-versa to hold securities for investors which are established in foreign countries different from that where the participant is established. Since the criteria and thresholds to be defined by ESMA for determining “substantial importance” are meant to involve host authorities from a safety and investor protection perspective, the “nationality” of CSD participants is largely irrelevant since it might be totally different from that of the actual holders of the security.

Furthermore, we note that the proposed denominators for the thresholds’ calculations will often not be available to the CSD, and that the relevant data but thus be collected by the competent authority. This is the case for:

* The nominal value of securities "non-centrally maintained" by all CSDs established in the EU;
* The nominal value of the FoP settlement instructions settled by all CSDs established in the EU;
* The nominal value of settlement instructions settled by all CSDs established in the EU from participants as well as for other holders of securities accounts of the host Member State.

ECSDA supports ESMA’s decision not to include collateral management services in the assessment of the threshold for the “central maintenance service”.

Finally, as regards Section 3.3 of the Consultation Paper on the notary service (p.19-20), ECSDA believes that the proposed indicators are more appropriate.

<ESMA\_QUESTION\_TA\_CSDR\_6>

Q7: What are your views on the proposed thresholds?

<ESMA\_QUESTION\_TA\_CSDR\_7>

ECSDA has no comments on the level of the proposed thresholds but we welcome ESMA's suggestion to undertake a simulation exercise before the draft technical advice is finalised in order to assess the number of authorities that would be required to establish cooperation arrangements as result of the proposed thresholds. ECSDA is currently collecting data from its members in support of the simulation exercise and we hope that the results will help achieve more workable criteria for determining the appropriate thresholds.

<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>

No comments.

<ESMA\_QUESTION\_TA\_CSDR\_8>