NASDAQ OMX

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Reply of Estonian CSD to Draft Technical Standards for the Regulation on Improving Securities Settlement in the European Union and on Central Securities Depositories (CSD), Discussion Paper

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ECSD has worked closely with ECSDA and its members in the course of preparing its views and comments to the discussion paper. Pleased find them attached to this letter as follows:

A) Questions 1 – 20

Please refer to **Annex 1** *"Building a European Settlement Discipline Framework that works"*, ECSDA comments on the ESMA Discussion Paper on CSDR technical standards (Part 1) of this letter. Having participated in the joint work of European CSDs *via* ECSDA, ECSD shares views, comments and responses contained in **Annex 1**.

B) Questions 21 – 54

Please refer to **Annex 2** *"A new framework for CSD authorisation and supervision"*.

We remain at your disposal for any further information or discussions on subject matter.

Respectfully,

Julia Segerkrantz
Member of the Management Board

ECSDA
European Central Securities Depositories Association

Annex 1

"Building a European Settlement Discipline Framework that works":

ECSDA comments on the ESMA Discussion Paper on CSDR technical standards (Part 1)

This paper constitutes the first part of ECSDA's comments on the ESMA Discussion Paper of 20 March 2014 on draft technical standards for the CSD Regulation ("CSDR")[1]. It covers questions 1 to 20 of the consultation and includes some additional comments.

We describe ECSDA's proposal for a harmonised European settlement discipline regime under the upcoming CSD Regulation. We have designed our proposal so that it is fully compatible with the Level 1 text of the Regulation, as published by the Council of the European Union on 24 April 2014 (outcome of the European Parliament's first reading[2]). We hope that this proposal will help ESMA in the drafting process for the CSDR technical standards under articles 6 and 7 of the Regulation. Whenever possible, we include some elements to be taken into consideration for the cost-benefit analysis to be included by ESMA in its impact assessment.

The recommendations contained in this paper are the result of joint work by European CSDs. They have also been discussed with market participants, including in the context of the T2S Harmonisation Steering Group task force on settlement discipline.

[1] http://www.esma.europa.eu/system/files/2014-299_discussion_paper_on_central_securities_depositories_0.pdf
[2] http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208512%202014%20INIT

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Executive Summary

The following table summarises ECSDA's proposal for a harmonised settlement discipline regime in the European Union. **Implementing such a regime will require considerable investments and adaptions from both CSDs and market participants.**

Level 1 CSD Regulation	**Level 2 technical standards – ESMA or EC "mandate"**	**Level 2 technical standards – ECSDA proposal for a harmonised EU settlement discipline regime**
Article 6(2): Measures facilitating settlement on ISD	*"the details of the procedures facilitating settlement referred to in paragraph 2 [i.e. settlement on the intended settlement date, including the promotion of early settlement on the intended settlement date]"*	**In order to promote settlement early on the intended settlement date (ISD), technical standards <u>should</u>:** (1) Make matching at CSD level compulsory, except (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) for FoP transfers among accounts managed by the same CSD participant (collateral movements, account allocations in direct holding markets) and (d) for other exceptional transfers such as those resulting from a Court order; (2) Require CSDs to offer matching possibilities continuously throughout the day. **Technical standards <u>could also</u>**: (3) Encourage CSDs to promote straight-through-processing (STP) and to use ISO standards whenever possible. However, the detailed communications standards to be used and the cases when manual intervention is required/acceptable should not be specified in Level 2 legislation; (4) Recommend the use of a matching tolerance amount of up to EUR 25, while allowing each CSD to decide on the most appropriate level of tolerance in consultation with its participants. **Technical standards <u>should not</u>**: (5) Prescribe certain matching fields. Mandating the use of certain matching fields pertains to the technical design of CSDs' system and goes beyond the mandate given to ESMA under the Level 1 Regulation. It is also unlikely to bring substantial benefits in terms of reducing the level of settlement fails.

Level 1 CSD Regulation	Level 2 technical standards – ESMA or EC "mandate"	Level 2 technical standards – ECSDA proposal for a harmonised EU settlement discipline regime
Article 6(3): Incentives for timely settlement	*"the details of the measures to encourage and incentivise the timely settlement of transactions referred to in paragraph 3"*	**In order to encourage and incentivise timely settlement by CSD participants, technical standards <u>should</u>:** (1) Require CSDs to give participants access to the status of their pending instructions (i.e. whether these are matched or unmatched); (2) Provide CSDs with a toolkit of measures that can be used, where appropriate, to enhance settlement efficiency. **Technical standards <u>could also</u>**: (3) Encourage (but not require) CSDs to provide a hold/release mechanism and/or bilateral cancellation facilities as part of the toolkit if there is a demand for such a functionality among CSD participants. **Technical standards <u>should not</u>**: (4) Impose requirements on CSDs' tariff structure (e.g. imposing a progressive tariff structure) to motivate CSD participants to send their matching and/or settlement instructions early on ISD; (5) Require CSDs to identify the causes of unmatched instructions; (6) Specify the detailed modalities (timing, format) for CSDs to provide information on pending instructions to their participants; (7) Prescribe how many batches of settlement are required by a CSD. Mandating a certain number of batches per day pertains to the technical design of CSDs' system and goes beyond the mandate given to ESMA under the Level 1 Regulation. It is also unlikely to bring substantial benefits in terms of reducing the level of settlement fails; (8) Prescribe any aspect of the technical design of a settlement system, such as standards for the speed at which information is disseminated electronically to participants, the use of partialling, technical netting etc.

Level 1 CSD Regulation	Level 2 technical standards – ESMA or EC "mandate"	Level 2 technical standards – ECSDA proposal for a harmonised EU settlement discipline regime
Article 7(1): Monitoring and reporting fails	*"the details of the system monitoring settlement fails and the reports on settlement fails referred to in paragraph 1"*	**CSDR technical standards on the monitoring and reporting of settlement fails <u>should</u>:** (1) Include a single, harmonised methodology (including contents and frequency) for CSDs to report settlement fails to their competent authorities: - In terms of *contents*, the "template" currently used by ESMA appears as a good basis. Further granularity should however be provided by requesting CSDs to report internal and cross system (=often cross border) settlement separately, and to distinguish between a maximum of 5 asset types (inspired by the broad categories of the CFI classification); - In terms of *format*, a machine-readable format like XML or spreadsheet-type format should be used to allow ESMA to easily aggregate the settlement fails data it receives; (2) Require CSDs to report fails on a monthly basis to their competent authority (with the possibility for authorities to obtain more frequent reports in crisis situations or upon request); (3) Require competent authorities, based on the monthly reports received from CSDs, to report back to ESMA with the same - monthly – frequency; (4) Define a minimum European template to be used by CSDs for disclosing settlement fails data to the general public. **Technical standards <u>could also</u>:** (5) Require that CSDs give their participants access to regular, at least monthly, reports on their individual level of settlement fails; (6) State that a CSD participant should be able to view its fails data both as deliverer and as receiver of securities, whether by accessing the CSD interface or as part of the monthly reports it receives from the CSD; (7) Require annual aggregate/anonymised settlement fails data to be made available on a dedicated page on the CSD's public website or on the public website of the relevant competent authority.

Level 1 CSD Regulation	Level 2 technical standards – ESMA or EC "mandate"	Level 2 technical standards – ECSDA proposal for a harmonised EU settlement discipline regime
Article 7(2): Late settlement penalties	ESMA Standards: *"the processes for collection and redistribution of cash penalties and any other possible proceeds from such penalties"* *EC Delegated Act: "parameters for the calculation of a deterrent and proportionate level of cash penalties referred to in paragraph 2 based on asset type liquidity of the instrument and type of transaction that shall ensure a high degree of settlement discipline and a smooth and orderly functioning of the financial markets concerned."*	**The upcoming EC delegated act on penalties for late settlement <u>should:</u>** (1) Require that the penalty fee for late settlement be an ad valorem fee with a fixed, per trade component aimed to cover the costs of maintaining the penalty system; (2) Determine a minimum amount for the fixed, per trade component of the penalty fee, allowing CSDs to cover the costs of developing and maintaining the system. Some flexibility for CSDs to go beyond this minimum amount is however necessary to account for the different costs across CSDs; (3) Recommend a mark-to-market approach for determining the reference price on which to calculate the penalty (as this would ensure that a single method is used for sourcing reference prices for both DvP and FoP instructions), on the condition that (a) CSDs can obtain the required pricing data, that (b) ESMA specifies the source of prices to be used, possibly based on a tender, having in mind however that the cost of using this source by CSDs would be one of the costs of maintaining the penalty system, and that (c) a solution is found for illiquid securities for which no reliable daily market price is available; (4) Exempt some FoP deliveries from penalties, such as transfers between securities accounts managed by the same participant (including between the accounts of a participant and of an account holder that is not a participant in direct holding markets); (5) Allow for a differentiated rate for calculating penalties for a maximum of two asset types, i.e. distinguishing between debt securities and transactions in all other financial instruments. There should be a single daily penalty fee rate for both categories of transactions; (6) Foresee the possibility for the calculation method to be adjusted over time to reflect changing market conditions. **The upcoming EC delegated act <u>should not</u>:** (7) Impose the use of a gross (single-instruction-based) or multilateral net model to all CSDs. CSDs should be allowed to choose either model. That said, a single model might be defined at the level of the T2S platform in the future if the Eurosystem ever decides to integrate a functionality facilitating the imposition of penalty fees by T2S participating CSDs. **The CSDR technical standards on the collection and redistribution of cash penalties <u>should</u>:** (8) Require CSDs to redistribute the penalty monies, after having deducted the part used to cover the CSD's costs of maintaining the system, whenever possible to the suffering party and, when this is not practical, to the community of participants or to projects that benefit the market as a whole.

Level 1 CSD Regulation	Level 2 technical standards – ESMA or EC "mandate"	Level 2 technical standards – ECSDA proposal for a harmonised EU settlement discipline regime
Article 7(3): Buy-ins	*"c) the details of operation of the appropriate buy-in mechanism, including appropriate time frames to deliver the financial instrument following the buy-in procedure referred to in paragraph 3. Such time frames shall be calibrated taking into account the asset type and liquidity of the financial instruments.* *d) the circumstances under which the extension period could be prolonged according to asset type and liquidity of the financial instruments, in accordance with the conditions referred to in point (a) of paragraph 4 taking into account the criteria for assessing liquidity under Articles 2(1)(7a) of MiFIR [MIFIR determination of 'liquid market'];* *e) type of operations and their specific timeframes referred to in point (c) of paragraph 4 that renders buy-in ineffective;* *f) A methodology for the calculation of the cash compensation referred to in paragraph 7."*	CSDs, given their low risk profile, should not be involved in the execution of buy-ins. Furthermore, buy-ins are about the enforcement of contractual obligations at the trading level, and it is unclear how such a process can be "policed" at the settlement level, even if the rules on buy-ins are contained in CSDs' rulebooks. ECSDA thus recommends that further discussions should take place between ESMA, market infrastructures and their users, after the consultation deadline of 22 May, to consider what processes could be put in place to enforce the CSDR buy-in rules in 'non-CCP' scenarios. We also think it will be important for CSDR technical standards on buy-ins to foresee a special treatment for illiquid securities, and that the criteria used to define such securities will also have to be considered in the context of penalties for late settlement under article 7(2).

Level 1 CSD Regulation	Level 2 technical standards – ESMA or EC "mandate"	Level 2 technical standards – ECSDA proposal for a harmonised EU settlement discipline regime
Art.7(9): Suspension of failing participants	*"the conditions under which a participant is deemed to consistently and systemically fail to deliver the financial instruments referred to in paragraph 9"*	Given the serious consequences the suspension of a CSD participant can have for financial markets as a whole, this measure should be considered only as the ultimate punishment in extreme cases. A quantitative threshold should in any case: - be reasonably low (e.g. below 75% of instructions settled on the intended settlement date, in volume or value, over a 12-month period), and - never automatically trigger the suspension of a participant.
Art.7(10): Settlement information necessary for executing buy-ins	*"the necessary settlement information [provided by a CSD] referred to in paragraph 10 [enabling CCPs and trading venues to fulfil their buy-in obligations]"*	**Technical standards <u>should</u>:** (1) Require CSDs to inform CCPs and/or, where appropriate, trading venues about the current status of instructions received from these CCPs/trading venues. The information to be provided should be specified in the transaction feed agreement signed between the relevant infrastructures, if applicable. **Technical standards <u>should not:</u>** (2) Impose the segregation of the accounts of all trading and clearing members at CSD level.

Introductory remarks

ESMA should take the following issues into consideration when preparing the draft CSDR technical standards on settlement discipline:

1. **The proposed technical standards should be proportionate, given that the level of settlement efficiency in Europe is already high (more than 98%[3]).** The objective of upcoming technical standards should be to give CSDs the necessary tools to promote efficient settlement, rather than to "punish" every participant failing to settle on time. In most cases settlement fails are neither intentional nor due to any fault of an individual but are for instance the result of problems in the holding chain. As acknowledged by the European Central Bank in a 2011 report on settlement fails[4], settlement failures can be due to a multiplicity of reasons such as delays caused by the use of a cross-border link, failure to deliver physical securities or even a lack of cash with the purchaser. Fails are not necessarily linked to naked short sales, and there will always be a certain "physiological" level of settlement fails even in highly efficient markets. Measures which are not expected to have a significant positive impact on the overall level of settlement efficiency should not be mandated when alternative, less complex and less costly measures can achieve a similar outcome.

2. **An overly prescriptive approach in CSDR technical standards could be detrimental if it prevents CSDs' settlement discipline regimes to be calibrated and further improved.** Technical standards should allow CSDs to make use of the most appropriate tools available to enhance settlement efficiency for each SSS they operate. As stressed in the ECSDA "Principles on settlement discipline" issued in June 2013[5], technical standards should not mandate each and every aspect of the discipline regime and be so detailed as to prevent CSDs from adapting to changing circumstances. Indeed, the most efficient markets have historically relied on flexible arrangements that can be calibrated as market conditions and practices evolve, for example allowing infrastructures to adjust the type of incentives or penalties in place following consultations with users, based on specific objectives and/or on specific issues identified for each SSS in the market(s) where the given CSD operates. More specifically, an overly penal regime runs the risk of forcing participants down the path of settlement internalisation, or may even drive end investors away from cash markets and into the derivatives space.

3. **The timing for rolling out settlement discipline measures under the CSD Regulation**

[3] Using a harmonised methodology covering 19 European markets, ECSDA calculated that, in March 2012, the settlement efficiency rate, measured by the number of instructions settling on the intended settlement date (ISD) divided by the total number of settlement instructions, was 98.9% in value terms and 97.4% in volume terms. See http://www.ecsda.eu/uploads/tx_doclibrary/2012_09_18_ECSDA_Statistical_Exercise.pdf
[4] See http://www.ecb.europa.eu/pub/pdf/other/settlementfails042011en.pdf
[5] http://www.ecsda.eu/uploads/tx_doclibrary/2013_06_10_ECSDA_Settlement_discipline.pdf

should be phased. As stressed in a joint industry letter sent to EU policy-makers in November 2013 by European trade associations representing CSDs, CCPs and their users[6], the parallel implementation of TARGET2-Securities and of the move to a T+2 settlement cycle need to be taken into account as all sectors of the market, not just CSDs, will have their roadmaps fully consumed by these projects. A transition period of maximum 3 years (2015-2017) would allow market participants, as well as infrastructures, to make the necessary adaptations and avoid an unnecessarily complex and costly implementation of some functionalities that will be provided by T2S. ESMA should not underestimate the changes required in CSD systems to accommodate for a harmonised settlement discipline regime (e.g. database changes, introduction of new messages, new billing mechanism…). Such changes not only take months to implement, but they must also be reflected by CSD participants so that they can pass on fines to their own clients, if appropriate. As a result, the priority of EU law-makers should be to ensure that all CSDR technical standards are adopted on time, and prior to the launch of T2S in June 2015, while at the same time allowing for a realistic timeline for CSDs to fully implement the settlement discipline standards, i.e. by 2017 after the 4th T2S migration wave is completed. Such timeline would need to be complemented by transitional provisions that adequately take into account related EU regulatory initiatives (e.g. Short Selling Regulation which is subject to a deletion according to Article 72a).

4. **CSDR technical standards should not include explicit references to TARGET2-Securities or to specific standards (such as ISO 20022).** Although ESMA should of course keep in mind the specific needs and functionalities of T2S when drafting the standards, technical standards should withstand the test of time and avoid referring to specific technical infrastructures, settlement solutions or standards, especially when the latter are subject to further evolutions, given that technical standards ultimately become binding legislation (so-called “Level 2” legislation).

5. **CSDR technical standards should set some minimum standards, but still allow CSDs to go beyond these standards in some cases**. For example, a centralised securities lending and borrowing facility can help reduce the level of settlement fails but will not always be an appropriate solution in all markets. CSDR technical standards should provide a common basis for all CSDs, while allowing CSDs to pick the most appropriate tools in the “settlement discipline toolbox” at their disposal, based on the needs of the market(s) in which they operate. This is also in line with Recital 16 of CSDR, stating that rules concerning penalties “should be adapted to the specificities of different securities markets”.

6. **CSDR technical standards should take into account existing standards supporting efficient matching and settlement of securities transactions such as the ESSF-ECSDA**

[6] See http://www.ecsda.eu/uploads/tx_doclibrary/2013_11_04_Joint_Letter_CSDR_Art7.pdf

Matching Standards of 2006[7]. However not all of those market standards are suitable to be translated into binding Level 2 legislation. They reflect 'best practices' which are often very detailed and not meant to be generally applicable. The standards are also necessarily subject to adjustments over time, in particular to reflect advances in technology and other market developments.

7. **Finally, it is important that the technical standards take into account the specific situation of direct holding markets** and ensure a fair and equal treatment of different account holding models in Europe. For example, account allocation movements between the accounts of end investors managed by the same CSD participant should be exempt from late settlement penalties, as the equivalent account allocation in omnibus account markets is internalised within the books of the banks and thus not even visible to the CSD.

[7] ESSF-ECSDA Matching Standards (2006): http://www.ecsda.eu/uploads/tx_doclibrary/2006_10_05_ESSF_ECSDA_Matching_Standards.pdf; and latest ECSDA status report on matching harmonisation (Nov 2013)

1. Trade confirmation – art.6(1)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 6(1): "**Trading venues** shall establish procedures that enable the confirmation of relevant details of transactions in financial instruments referred to in Article 5 (1) on the date when the transaction has been executed.
Notwithstanding the requirement set out in the first sub-paragraph, **investment firms** authorised pursuant to Article 5 of Directive .../.../EU [new MiFID] shall, where applicable, put in place arrangements to limit the number of settlement fails. Such measures shall at least consist of arrangements between the investment firm and its professional clients to ensure the prompt communication of an allocation of securities to the transaction, confirmation of that allocation and confirmation of the acceptance or rejection of terms in good time before the intended settlement date.
ESMA shall, in close co-operation with the members of ESCB, issue guidelines in accordance with Article 16 of Regulation (EU) No 1095/2010 on the standardised procedures and messaging protocols to be used referred to in the first sub-paragraph.".

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

"measures to be taken by investment firms in accordance with the first subparagraph of paragraph 1"

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?

Unlike trading venues and investment firms, CSDs are not directly in the scope of article 6(1) on trade confirmation. ECSDA thus does not comment on question 1 of the Discussion Paper.

2. Measures facilitating settlement on ISD – art.6(2)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 6(2): "For each securities settlement system it operates, a CSD shall establish procedures that **facilitate the settlements of transactions** in financial instruments referred to in Article 5(1) **on the intended settlement date** with a minimum exposure of its participants to counterparty and liquidity risks and a low rate of settlement fails. It shall promote early settlement on the intended settlement date through appropriate mechanisms".

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

"the details of the procedures facilitating settlement referred to in paragraph 2"

A. ECSDA Proposal

In order to promote settlement early on the intended settlement date (ISD), technical standards should:

(1) Make matching at CSD level compulsory, except (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) for FoP transfers among accounts managed by the same CSD participant (collateral movements, account allocations in direct holding markets) and (d) for other exceptional transfers such as those resulting from a Court order;
(2) Require CSDs to offer matching possibilities continuously throughout the day.

Technical standards could also:

(3) Encourage CSDs to promote straight-through-processing (STP) and use ISO standards whenever possible. However the detailed communications standards to be used and the cases when manual intervention is required/acceptable should not be specified in Level 2 legislation;
(4) Recommend the use of a matching tolerance amount up to EUR 25, while allowing each CSD to decide on the most appropriate level of tolerance in consultation with its participants.

Technical standards should not:

(5) Prescribe certain matching fields. Mandating the use of certain matching fields pertains to the technical design of CSDs' system and goes beyond the mandate given to ESMA under the Level 1 Regulation. It is also unlikely to bring substantial benefits in terms of reducing the level of settlement fails.

B. Analysis of the different options

(1) Promoting automation, STP, and international communication standards

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.

Automation and the promotion of straight-through processing (STP) is core to the CSD business. ECSDA agrees that all processes should be designed to function on an STP basis "by default", but we caution ESMA against imposing STP or limiting explicitly the number and type of cases when manual intervention is allowed.

Indeed, as in most businesses, manual intervention is needed on occasion, in particular where corrective actions are required, or in times of crisis. There is no need for ESMA to restrict manual intervention in regulatory technical standards, especially given the difficulty of defining "manual intervention" (would this refer to interventions made by the CSD or by CSD participants? Does access to a CSD's graphical user interface count as manual intervention?) and the multiplicity of cases when such intervention might be required to ensure timely settlement (often in exceptional circumstances).

For example, for some OTC transactions, CSD participants manually amend their instructions to reflect information received from their own clients (e.g. using an MT599 message) instead of having to cancel and re-instruct in the settlement system. Manual processes are also sometimes needed for corporate actions, redemptions/coupon payments, stripping instructions or the handling of bankruptcies and similar exceptional circumstances. Settlement via direct links can, depending on the respective CSD system, also require some manual intervention for the CSD and/or its participants.

Furthermore, Standard 11 of the ESSF-ECSDA Matching Standards foresees that the instruction process in the CSD should enable the 'amendment' of instructions in non-matching relevant areas rather than the cancellation and resubmission of the trade. Such flexibility supports the smooth processing of instructions and should be preserved.

ECSDA believes that **ESMA standards should encourage automation whenever this increases the efficiency and safety of the system. But mandating automation and limiting the type of exceptions (="manual intervention") in Level 2 legislation could be counterproductive and actually reduce settlement efficiency, removing all flexibility for CSDs and their participants.** CSDs must have full discretion as to when manual intervention is necessary.

In line with the response of the T2S community to ESMA, ECSDA insists that manual intervention should be allowed in the CSD rules of procedures.

Besides, it should be noted that STP at CSD level is also dependent on the level of automation of CSD participants and linked infrastructures. For instance, implementing "already matched" functionalities whereby the trading or clearing infrastructures use a Power of Attorney to instruct the CSD on behalf of participants is a good way to promote STP and reduce the likelihood of fails. These functionalities can also help achieve compliance with Article 6(1) requiring trading venues to "establish procedures that enable the confirmation of relevant details of transactions".

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

ESMA regulatory technical standards could seek to encourage the use of communication procedures and standards that facilitate STP, in line with the CPSS-IOSCO Principles for financial market infrastructures. However, **Level 2 legislation should not mandate the use of specific communication standards (e.g. ISO 20022): this would not only be disproportionate, but it would also "lock" the rules with the standards in use at a given time and cause problems once the standards evolve into new ones.**

At most, ESMA could introduce a general reference to ISO standards in the technical standards, but a more precise reference to individual standards (e.g. to ISO15022 or ISO20022) should be avoided. Indeed:

- ISO standards do not cover all functionalities and services offered by CSDs and in some cases, limiting CSD communication standards to ISO standards would result in the discontinuation of some services that are helpful to market participants and support an efficient settlement process. Examples include messages for static data, certain reports

including settlement discipline related reporting, the SBI trade confirmation service in the French market, communication of end investors details in the Spanish market, cash settlement forecasts in the Polish market, as well as many of the account level services offered by CSDs in direct holding markets.

- Technical standards for other infrastructures (trading venues and CCPs) do not go into this level of detail, and there is no reason to adopt a prescriptive approach on communication standards for CSDs.
- In some cases, other communication standards than ISO standards might be appropriate to enhance settlement efficiency and STP, in particular for CSDs not participating in T2S. In such cases, local standards should be allowed, on the condition that they are publicly available.

Furthermore, we note that the scope of article 6(2) is restricted to the settlement process, while in practice CSDs will look to develop automated processes and use harmonised communications standards for other processes as well, such as the maintenance of securities accounts. Introducing overly detailed requirements on communication standards for settlement in Level 2 legislation could thus be counterproductive if it hampers CSDs' ability to adopt a holistic approach to support STP for all their processes and activities.

All in all, ECSDA does not believe that technical standards aiming to implement CSDR article 6(2) need to cover automation and communication standards, especially given that article 35 of the Regulation already covers communication procedures and is not subject to Level 2 legislation. We believe that standards on matching processes (see thereafter) would be more appropriate to fulfil ESMA's mandate under article 6(4).

(2) Matching of settlement instructions

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?

(a) Compulsory matching

ECSDA agrees with ESMA that, for transactions which have not been matched by a trading venue or a CCP, matching should be compulsory at CSD level, but we believe more exceptions need to be considered, in particular:

- in the context of corporate actions processing;
- for certain free of payment (FoP) transfers among securities accounts managed by the same CSD participant, and not necessarily "opened in the name of the same participant" (see below);
- in the context of multilateral systems without CCP intervention (i.e. when instructions are not entered into the settlement system by the CSD participants, but are received via a trade feed);
- when instructions are processed as a result of a Court order (e.g. insolvency proceedings).

ECSDA agrees with ESMA that FoP instructions between accounts opened in the name of the same participant should be excluded from the compulsory matching requirement since these are typically collateral movements, portfolio transfers or account allocation movements, especially in direct holding markets. Nonetheless, we believe that the phrase "accounts opened in the same of the same participant" should be replaced by "accounts ***managed by*** the same participant" in order to cover all direct holding models.

Indeed, in direct holding markets, securities can be held in accounts belonging to end investors / customers of the CSD participant, not on the CSD participant's account. As a result, a transaction on

behalf of an end investor can be effected in one of the following ways:

(a) Securities may be transferred directly from the account of a customer of Participant A (or from Participant A's account) to the account of a customer of Participant B; or
(b) Securities can be transferred from the account of Participant A to the account of Participant B in one transaction, and then Participant B can instruct another transaction between its account and the account of its customer.

In scenario (b), the second transaction allocating securities from Participant B's account to the account of the customer of Participant B is only effected by one participant, and so compulsory matching is not feasible. The same applies to other transactions between accounts managed by the same CSD participant (collateral movements, portfolio transfers etc.).

Importantly, the account of a Participant's customer can either be an account for which the Participant is the account operator (as mentioned under CSDR article 31) **or an account on which the Participant has been given a Power of Attorney**. **In the latter case, the account is managed by the same Participant, but might have been opened in a different name from that of the Participant (e.g. directly in the Participant customer's name). It is thus important to extend the exemption from compulsory matching for all FoP instructions between accounts managed by the same Participant.**

Provided these conditions are recognised in the upcoming technical standards/delegated acts, ECSDA would not oppose a general requirement for compulsory matching in the CSDR technical standards. We note however that today, in some countries (BE, DK, FR, NL, NO), FoP instructions do not always require matching and that this will constitute a change in market practice for CSD participants.

(b) Continuous matching

Most CSDs already offer real-time matching throughout business day, in line with the ESSF-ECSDA Standard 3. **CSDR technical standards should include a general requirements for CSDs to offer matching possibilities throughout the business day, as a means to facilitate early matching and timely settlement.**
We note, however, that requiring real-time matching to be provided by all EU CSDs during the day will require system changes in some markets (BG, CY, GR) and that sufficient time should be given to these markets for making the necessary adaptations.

(c) Standardised matching fields

There is no need for technical standards to go as far as mandating the use of certain matching fields (e.g. in line with T2S matching fields). In any case, technical standards should not contain a direct reference to TARGET2-Securities, and any requirement should take into account the needs and circumstances of non-T2S CSDs. For example, there is a mandatory T2S matching field called "CSD of the counterparty", but this field will not be relevant in a pure domestic context outside of T2S, and should thus not be mandatory. Moreover, even T2S participating CSDs need flexibility to use matching fields for their internal transactions to allow the provision of additional services to their participants, for example, to prevent cross-matching. Finally, it is also worth noting that T2S matching fields are still under discussion and subject to changes in the future, based on further project developments. 'Fixing' compulsory matching fields in Level 2 legislation would thus create considerable (and unnecessary) constraints by requiring a revision of the law every time there is a need for updating the rules on compulsory matching fields.

ECSDA recalls that Standard 1 of the ESSF-ECSDA matching standards (2006) already contains a list of harmonised matching fields and that there is no need to create additional binding requirements. In

fact it is important that CSDs can retain flexibility in using other matching fields, including optional fields, so as to adapt to local market reality (e.g. end investor information in direct holding markets). Client codes should remain an optional matching field. **Mandating the use of certain matching fields would, according to ECSDA, go beyond the mandate given to ESMA under the Level 1 Regulation, and is unlikely to bring substantial benefits in terms of reducing the level of settlement fails.**

(d) Use of matching tolerance amounts

In order to facilitate the matching process and timely settlement, many CSDs have introduced a "tolerance amount" which, according to ESSF-ECSDA Standard 17, should not exceed EUR 25. CSDs also have the option to use a lower tolerance threshold of up to EUR 2 for retail-sized transactions (below EUR 100,000).

According to a 2013 survey by ECSDA[8], at least 9 CSDs have a EUR 25 threshold in place today, 12 CSDs use a lower amount, and 8 CSDs have EUR 0 tolerance. Sometimes in the latter case, the CSD offers the matching tolerance functionality in its settlement system but the amount is set at 0 at the request of participants.

Should CSDR technical standards recommend the use of matching tolerance amount to facilitate timely settlement, **ECSDA believes that the standards should allow CSDs to determine the appropriate optional tolerance amount in consultation with their participants, from EUR 0 up to EUR 25 (or approximate counter value in the relevant currency).**

The use of a different tolerance amount for retail-sized transactions should remain optional. Today, only 5 CSDs apply a different threshold for retail-size transactions: CSD Prague (CZK 50 instead of CZK 600), Euroclear Finland (EUR 2 instead of EUR 25), KDPW (PLN 8 instead of PLN 100), KDD (EUR 2 instead of EUR 25) and Euroclear UK and Ireland (GBP 0 instead of GBP 10 since members can opt out of matching tolerance for retail transactions).

[8] See the ECSDA report on matching harmonisation published in November 2013: http://www.ecsda.eu/uploads/tx_doclibrary/2013_11_18_ECSDA_Matching_Report.pdf

3. Incentives for timely settlement – art.6(3)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 6(3): "For each securities settlement system it operates, a CSD shall provide measures to **encourage and incentivise the timely settlement** of transactions by its participants. CSDs shall require participants to settle their transactions on the intended settlement date."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

"the details of the measures to encourage and incentivise the timely settlement of transactions referred to in paragraph 3"

A. ECSDA Proposal

In order to encourage and incentivise timely settlement by CSD participants, technical standards should:

(1) Require CSDs to give participants access to the status of their pending instructions (i.e. whether these are matched or unmatched);
(2) Provide CSDs with a toolkit of measures that can be used, where appropriate, to enhance settlement efficiency.

Technical standards could also:

(3) Encourage (but not require) CSDs to provide a hold/release mechanism and/or bilateral cancellation facilities as part of the toolkit if there is a demand for such a functionality among CSD participants.

Technical standards should not:

(4) Impose requirements on CSDs' tariff structure (e.g. imposing a progressive tariff structure) to disincentive the late input of settlement instructions;
(5) Require CSDs to identify the causes of unmatched instructions;
(6) Specify the detailed modalities (timing, format) for CSDs to provide information on pending instructions to their participants;
(7) Prescribe how many batches of settlement are required by a CSD. Mandating a certain number of batches per day pertains to the technical design of CSDs' system and goes beyond the mandate given to ESMA under the Level 1 Regulation. It is also unlikely to bring substantial benefits in terms of reducing the level of settlement fails;
(8) Prescribe any aspect of the technical design of a settlement system, such as standards for the speed at which information is disseminated electronically to participants, the use of partialling, technical netting etc.

B. Analysis of the different options

(1) Incentives for early input of settlement instructions

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?

(a) Financial disincentives for the late input of settlement instructions

The difference between the measures covered under article 6(2) and article 6(3) of the CSD Regulation is not entirely clear from the Level 1 text, but ECSDA understands that **article 6(3) aims to focus on incentive measures**, whether for early matching or early settlement. Early matching or early settlement means that instructions are communicated to the CSD, whenever possible, early on or before the business day rather than just before the applicable deadline.

Different incentives can be developed to encourage market participants to instruct early in the business day or before, but such incentives are typically market-specific and cannot necessarily be generalised. De facto, the existence of a late settlement penalty regime (under article 7) already constitutes a strong disincentive to settle late and thus also to instruct late, since this increases the likelihood of a fail. Very few CSDs (FR, SE, UK) have established financial incentives for early matching, and there is no evidence that these markets have greatly improved settlement rates compared to those markets where no such incentives exist. Given the high matching rates in other markets that do not have such financial incentives in place, it is doubtful whether the compulsory introduction of a late matching fee in all EU markets would have any benefits[9].

The introduction of a late matching fee or other financial 'disincentive' for late matching should thus be only one tool, among many others, that a CSD can adopt if this is appropriate to enhance settlement efficiency given the local market circumstances (e.g. if the CSD observes that too many participants tend to instruct late in the day). Besides, the moment an instruction is matched often does not depend only on the CSD participant but also on the relevant processes in the CCP and/or trading venue involved. In such cases, late matching fees are not an appropriate tool. And, even when a surcharge for late matching is applied, it must take into account special cases, e.g. exemptions might be needed for certain financial instruments like repos that settle same day and for CCP-cleared transactions. The case of CSDs not offering night-time settlement and the impact of the T2S tariff structure[10] for T2S-participating CSDs should also be taken into account.

We also note that, when applicable, a late matching fee should take the trade date and the settlement cycle into account (for example, defining "late matching" as "matching completed after trade date" rather than on "ISD-2"). Otherwise there would be an incentive for brokers to use, where possible, longer settlement cycles in order to benefit from early matching discounts (for transactions not falling under the T+2 obligation under CSDR article 5).

ECSDA thus does not agree with ESMA's suggestion that "settlement instructions which are not received by the CSD by the end of ISD-2 should be subject to disincentives by the CSD", if this means that all CSDs would be required to apply financial disincentives to instructions matched or input late, even if these settle on time. **Generally speaking, the details of a CSD's tariff structure, including disincentives for late matching/late input of settlement instructions, should not be imposed by law. A progressive tariff structure is only one means of promoting early settlement and should not be imposed in those markets where no need has been identified.** CSDs should be allowed, but not obliged to, use a progressive tariff structure.

(b) Hold/release mechanism and bilateral cancellation facilities

In paragraph 24 of the discussion paper, ESMA suggests that *"in order to incentivise early matching, CSDs should offer hold/release and bilateral cancellation facilities, without prejudice of the Settlement Finality Directive provisions".*

Some ECSDA members already offer a hold/release functionality to their participants, and T2S CSDs

[9] For more details, see http://www.ecsda.eu/uploads/tx_doclibrary/2011_07_07_ECSDA_Fails_Report.pdf
[10] T2S will introduce a surcharge of EUR 0.15 on "intended settlement date failed transactions" from 2015 onwards, and the tariff system for T2S will contain a differentiation between night-time and day-time processing.

in particular are expected to offer such a mechanism, in line with ESSF-ECSDA Standard 9. There are however different aspects to a hold and release mechanism and some CSDs only provide for part of the service (e.g. possibility to release an instruction put on hold, but not necessarily to put on hold an instruction already released), often due to a lack of demand by market participants.

ECSDA believes that regulatory technical standards should not mandate such specific technical functionalities, which are anyway difficult to define in legislation and are unlikely in themselves to significantly reduce the number of settlement fails. We however recognise that CSDs should be encouraged to offer a hold/release mechanism as a best practice if there is a demand from their participants.

As regards bilateral cancellation facilities, ESSF-ECSDA Matching Standard 6 does not impose the use of bilateral cancellation facilities once instructions are matched. Today, some CSDs still allow for unilateral cancellations, for example as a way to amend an instruction ("cancel and replace").

ECSDA recognises that bilateral cancellation facilities are a best practice and that CSDs should be encouraged to offer such functionality based on market demand. However, there is no reason to mandate this in technical standards.

(c) Informing participants about unmatched instructions

In paragraph 25 of the discussion paper, ESMA suggests that *"CSDs should develop a procedure to inform participants about pending settlement instructions of counterparties. Participants should be able to know that their instruction did not match the reason why. This information could be made available by the CSD within 30 minutes maximum, or similar cap after the first unsuccessful matching attempt; and at the beginning of ISD."*

ECSDA agrees that **CSDs should provide their participants with up-to-date information on the status of their pending instructions**, whether in "push" mode (e.g. reporting) or "pull" mode (e.g. access to the matching status of an instruction via an online interface or upon request). **However we do not think that the detailed modalities on how this information needs to be accessed should be specified in Level 2 legislation** (e.g. within *x* minutes, with what kind of message/interface). The practical modalities typically depend on the technical design of each CSD's system and on participants' preference based on the costs involved. The most important thing is that participants should have an easy access to such information.

Importantly, ESMA should recognise that that **CSDs are not always in a position to identify the reasons why an instruction has not been matched.** Requiring the CSDs to investigate the causes of an unmatched instructions would potentially require manual intervention and expose the CSD to legal risks. CSD participants are best placed to understand the business context in which a transaction has failed to match. In the T2S platform, for example, CSDs may be able to check whether a settlement instruction is matched, but they will not receive information on the underlying cause why an instruction is not matched.

As a result, CSDR technical standards should contain a general requirement for CSDs to allow participants to access the matching status of pending instructions. But technical standards should not go as far as:
- requiring CSDs to identify and provide information on the causes for unmatched instructions;
- specifying the detailed modalities (timing, format) for providing such information.

(d) Other tools to incentivise early settlement

Some CSDs (e.g. AT, FR) offer pre-matching facilities which also encourage participants to match

early. As with other types of incentive measures, such facilities should not be mandated in regulation but rather be allowed so that they can be adopted in those markets where a need has been identified. We also note that, outside of the CSD environment, the encouragement of the use of automated trade confirmation mechanisms can assist in early matching and hence early settlement.

(2) System functionalities

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.

(a) Settlement batches

ECSDA agrees with the general analysis provided by ESMA in paragraphs 26 to 29 of the Discussion Paper, but we are however not convinced about the penultimate sentence of paragraph 29 suggesting that *"all CSDs should be obliged to offer at least three daily settlements (batches), unless they operate on an RTGS basis".*

Today, some European CSDs work with batches for securities settlement and some of them have less than 3 settlement batches a day, usually because there is no market demand. **In the absence of any evidence that this will reduce settlement fails, ECSDA does not think that ESMA should mandate a specific number of batches per day**.

Should ESMA however consider imposing the use of 3 settlement batches per day as a minimum requirement in the future, it is essential that CSDs be given sufficient time, i.e. at least 5 years, to implement the change, given that this would require considerable investments and, in some cases, the implementation of an entirely new system.

(b) Other system functionalities

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 technical functionalities listed by ESMA in paragraph 30 of its Discussion Paper are used by CSDs to facilitate timely settlement are part of a "toolkit" that cannot be mandated for all CSDs in all cases. Generally speaking, CSDR technical standards should ensure that CSDs are allowed to pick the most appropriate tools to enhance settlement efficiency in their market, but should not seek to mandate specific tools when there is no evidence that such tools would substantially benefit settlement efficiency at European level.

For example, **mandating the use of technical netting and other optimisation algorithms, partial settlement or trade shaping functionalities, is clearly not justified and would go beyond the Level 1 mandate granted to ESMA.** Such functionalities are not always required in a given market, and for example the shaping of trades is not a functionality offered in TARGET2-Securities, and, if provided at all, can in fact be more efficiently provided at the level of the CCP , rather than at CSD level.

Taken into account the fact that:

- The level of settlement efficiency in Europe is already close to 100%,
- The majority of EU CSDs have joined T2S,
- T2S will provide functionalities such as optimisation algorithms (technical netting), partial settlement, and the recycling of instructions,

it is unnecessary, burdensome and costly to require CSDs to develop these functionalities.

(3) Lending facilities

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.

Securities lending and borrowing (SLB) facilities should not be mandated in technical standards but should rather be considered as one possible option to prevent settlement fails. SLB facilities (where the CSD acts as agent between lenders and borrowers) are offered by CSDs today in some markets, but not all CSDs should be expected to develop a central facility. The costs of implementing a central system will not always be justified, and it is worth noting that some of the largest markets in Europe (e.g. UK, FR) operate very efficiently without centralised SLB facilities.

Given that authorised CSDs already have the possibility, but not the obligation to offer SLB services under Section B of the Annex of the Level 1 CSD Regulation ("organising a securities lending mechanism, as agent among participants of a securities settlement system"), **there is no need for technical standards to cover SLB services of CSDs.** SLB services are just another part of the toolkit available to CSDs to use when deemed appropriate.

4. Monitoring and reporting settlement fails – art.7(1)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 7(1): "For each securities settlement system it operates, a CSD shall establish a system that monitors settlement fails of transactions in financial instruments referred to in Article 5(1). It shall provide regular reports to the competent authority and the authorities referred to in Article 11, as to the number and details of settlement fails and any other relevant information. These reports, including the measures envisaged by CSDs and their participants to improve settlement efficiency, shall be made public by CSDs in an aggregated and anonymised form on an annual basis. The competent authorities shall share with ESMA any relevant information on settlement fails."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

"the details of the system monitoring settlement fails and the reports on settlement fails referred to in paragraph 1"

ANNUAL REPORTING BY ESMA ON CROSS-BORDER SETTLEMENT FAILS:

Article 69(1): "ESMA, in cooperation with EBA and the authorities referred to in Articles 9 and 11, shall submit annual reports to the Commission [including among others] an assessment of the following:
(...) (a) settlement efficiency for domestic and cross-border operations for each Member State based on the number and volume of settlement fails." amount of penalties referred to in Article 7(4), number and volumes of buy-in transactions referred to in Article 7(4) and any other relevant criteria;

A. ECSDA Proposal

The CSDR technical standards should:

(1) Include a single, harmonised methodology (including contents and frequency) for CSDs to report settlement fails to their competent authorities:
   - In terms of *contents*, the "template" currently used by ESMA appears as a good basis. Further granularity should however be provided by requesting CSDs to report internal and cross system (=often cross border) settlement separately, and to distinguish between a maximum of 5 asset types (inspired by the broad categories of the CFI classification);
   - In terms of *format*, a machine-readable format like XML or spreadsheet-type format should be used to allow ESMA to easily aggregate the settlement fails data it receives.

(2) Require CSDs to report fails on a monthly basis to their competent authority (with the possibility for authorities to obtain more frequent reports in crisis situations or upon request);

(3) Require competent authorities, based on the monthly reports received from CSDs, to report back to ESMA with the same - monthly - frequency.

(4) Define a minimum European template to be used by CSDs for disclosing settlement fails data to the general public.

Technical standards could also:

(5) Require that CSDs give their participants access to regular, at least monthly, reports on their individual level of settlement fails;

(6) State that a CSD participant should be able to view its fails data both as deliverer and as receiver of securities, whether by accessing the CSD interface or as part of the monthly reports it receives from the CSD;

(7) Require annual aggregate/anonymised settlement fails data to be made available on a dedicated page on the CSD's public website or on the public website of the relevant

competent authority.

B. Analysis of the different options

(1) Contents of the settlement fails reports sent by CSDs to regulators

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.

(a) A single European template for CSD reports on settlement fails

ECSDA believes that **a truly harmonised methodology should be used by all EU CSDs for reporting on settlement fails to their regulators**. A harmonised methodology is indispensable to allow for comparability across markets, and for a meaningful aggregation of settlement fails data at EU level. This methodology should be included in the CSDR technical standards and should be based on the existing ECSDA methodology of February 2010[11], although more granular criteria need to be added (e.g. allowing for the distinction between domestic and cross-border settlements). The current "template" used by ESMA for collecting reports from national regulators also constitutes a workable basis for the harmonised fails reporting requirements, but will require some clarifications and improvements.

For example, we think that it would be more efficient for ESMA to collect absolute number on the volume and value of fails, rather than percentages. National regulators and/or ESMA will easily be able to calculate percentages based on the figures provided, and such an approach would ensure consistency.

Moreover, ECSDA understands that EU regulators would like to be able to compare the level of settlement fails across asset classes, and at domestic and cross-border level, to be able to develop specific recommendations for specific types of transactions. We note that article 69(1)(a) also requires ESMA to report annually on settlement efficiency, including a distinction between *"domestic and cross-border operations for each Member State".*

We think that the main challenge of the harmonised EU methodology for reporting settlement fails will be to find a workable definition of:

- The different asset class or transaction types;
- Domestic versus cross-border (or internal versus cross-systems?) settlements.

Generally speaking, ECSDA is in favour of a harmonised template to be used by all CSDs for reporting fails to their regulators on a monthly basis. Whereas regulators will always have the possibility to request additional details on an ad hoc basis, we believe that the CSDR technical standards should be seen as an opportunity to harmonise the reporting standards across all EU markets, thereby facilitating the aggregation of fails data at European level.

(b) Fails data on different asset classes

On the distinction between asset classes, there is no universal and readily available classification of existing financial instruments that could be used as such for the purpose of settlement fails reporting. Whereas creating a common taxonomy of financial instruments, which each ISIN code

[11] See http://www.ecsda.eu/uploads/tx_doclibrary/2010_02_28_ECSDA_Statistical_Exercise_01.pdf

being assigned to a specific category, is an overambitious aim, the use of broadly defined categories has at least the merit of avoiding that CSDs each provide their own groupings of financial instruments and would ensure a sufficient degree of comparability, notwithstanding the possibility that the same (type of) instrument might occasionally fall in a different category depending on the interpretation made by the reporting CSDs or their competent authorities.

We thus recommend that **ESMA should broadly define up to 5 categories of instruments for the purpose of settlement fails reporting, allowing each CSD to collect fails data per asset type without that this require technical changes or major investments in CSD's own reporting systems.**

For example, the following categories of asset classes could be used, based on the CFI classification[12]:

- **Equities ("E" category in CFI, except category EU on investment fund units);**
- **Investment fund units ("EU" category);**
- **Debt instruments ("D" category except category DY on money market instruments);**
- **Money market instruments ("DY" category);**
- **All other securities.**

The five categories above will largely suffice, and in any case the total number of categories to be reported for settlement fails purpose, to be manageable, should not exceed 5.

In case ECSDA's proposed categories would be adopted by ESMA, we note that CSDs will have to make adaptations to their current systems as such distinction is not currently used for the purpose of settlement fails reporting. For CSDs not acting as national numbering agencies (NNAs) in particular, solutions will have to be found to acquire the data necessary to the proper categorisation of financial instruments.

(c) "Domestic" and "cross-border" fails

On the <u>distinction between domestic and cross-border transactions</u>, ECSDA notes that there are different definitions of the terms, not all of which are practical from the CSDs' perspective. In fact, from the point of view of a CSD, it is only possible to distinguish between:

- **"internal settlements"** , i.e. settlement between two participants of that CSD, and
- **"external settlements"**, i.e. settlement between a participant of that CSD and the participant of another, linked CSD, whereas the account of the investor CSD is credited/debited by the Issuer CSD.

In practice, external, i.e. cross-system settlements will often but not always be cross-border settlements. An "internal" settlement within a CSD is in turn typically considered as "domestic", but it could very well be that the underlying investors in the securities are from a different country than that where the securities were issued and settled. Furthermore, in the case of indirect links whereby an investor CSD holds securities at an issuer CSD via the account of an intermediary (considered as a 'domestic' CSD participant by the issuer CSD), transactions will appear as "internal settlements", given that there is no direct link between the two CSDs. In such cases, and provided that the information is available to the issuer CSD, ESMA should clarify whether and how it expects the CSD to report such transactions.

Indeed, defining a domestic or cross-border transaction based on the domicile of the investor, as was

[12] See http://www.anna-web.org/index.php/home/cfiaiso10962

done in the 2011 Oxera study[13], for example, would be impossible to implement since CSDs often do not have any information on the identity, let alone on the domicile, of the underlying investors in the securities. Moreover, the domicile of CSD participants, where it is known to the CSD, is not relevant for the purpose of identifying whether a securities delivery is truly non-domestic, since the underlying investor in securities might be from a country different from the one where the securities were issued and settled.

As a result, ECSDA recommends that ESMA should require CSDs to report fails data on "internal" settlements and on "external settlements" (e.g. deliveries made via a link) separately. Given the fact that links are primarily used in the context of cross-border settlements, such reporting would allow ESMA and the EU Commission to assess the level of settlement efficiency in a cross-border context.

(d) Information on the failing participants

On the **identity of the failing participants**, ECSDA believes that:

- Regulators should receive fails data at the aggregate level (all participants) by default;
- Regulators should have the possibility to request details about the level of fails of an individual participant of an ad hoc basis, e.g. in case of specific concerns with certain actors in the market;
- Systematically providing details on the identity of the failing participant for each failed instruction would result in lengthy, complex and unnecessarily burdensome reports to regulators;
- Even in cases where the regulator receives information on the settlement performance of an individual participant, the regulator will often not know who is behind the fail (e.g. among the many underlying clients of a given CSD participant) and will need to obtain further information from the market participant in question. CSDs themselves often cannot identify the original failing party, e.g. when omnibus accounts are used.

(e) Format of the settlement fails reports sent to regulators

ECSDA supports the use of a machine-readable format, such as Excel or XML. We believe that such formats will allow ESMA to more easily aggregate the reports received from national regulators.

(2) Frequency of the settlement fails reports sent by CSDs to regulators

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

ESMA should seek to harmonise the frequency of CSDs' reports to their regulator(s) in order to facilitate the aggregation of EU-wide data on a regular basis. **Currently, most CSDs report fails to competent authorities on a monthly basis and such frequency thus appears appropriate, notwithstanding the possibility for authorities to request additional data from the CSD on an ad hoc basis.**

The monthly reports could however be required to contain daily data.

A daily reporting would clearly be disproportionate and overly burdensome (including for regulators),

[13] In the Oxera Study of May 2011 published by the European Commission DG MARKT, a 'domestic" transaction was defined as one where the domicile of the investor and the domicile of the security are the same, and a cross-border transaction as one where the domicile of the investor is different from that of the security. See: http://ec.europa.eu/internal_market/financial-markets/docs/clearing/2011_oxera_study_en.pdf

especially given the generally very high level of settlement efficiency in Europe. The operational and administrative costs for CSDs and national regulators having to process the data would be very substantial. Daily reporting on fails should rather be seen as a crisis management measure, e.g. when there is a problematic increase in the level of settlement fails in a given market.

Based on the monthly reports received from CSDs, regulators could be expected to report back to ESMA with the same – monthly - frequency.

(3) Settlement fails reports provided by CSDs to their participants

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

CSDR technical standards implementing article 6(3) should already require CSDs to give participants access to the status of their pending instructions (i.e. whether these are matched or unmatched). This information aims at preventing / managing fails.

Under article 7(1), the information communicated by the CSD to its participants refers to settlement fails information *ex post*, allowing participants to monitor the evolution in their level of settlement efficiency over time. The idea is that CSD participants should be able to access information on their own level of settlement fails. Such information can typically be obtained by CSD participants in one of two ways:

- By accessing their own fail reports in the CSD graphical user interface (GUI);
- By receiving regular (typically monthly) reports from the CSD on their level of settlement fails as deliverer.

ECSDA believes that some flexibility should be maintained as to how participants can access information on their own level of settlement performance. **CSDR technical standards could for instance require that CSDs provide monthly reports to their participants on their level of settlement fails**, but they should not specify the details of such reports (which will depend on user requirements). Today, CSDs provide fail information to their participant in their capacity as "deliverer", but not always as "receiver". In the future we agree that **a participant should be able to view its fails data both as deliverer and as receiver of securities, but such information should not necessarily have to be included in the monthly reports sent by the CSD to its participants if it can be obtained by using the CSD's graphical user interface (GUI).**

Moreover, a participant should be able to obtain historical fails data for its accounts at the CSD upon request.

In all cases, it should be possible for the CSD to charge a reasonable fee to cover the cost of producing and sending fails reporting to participants.

(4) Settlement fails reports provided by CSDs to the general public

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?

ECSDA believes that there would be value in technical standards defining a "minimum European template" to be used by CSDs for disclosing settlement fails data to the general public. This annual data should be aggregated to the level of all the CSDs' participants and include the following information:

- Total value of instructions settled by the CSD

- % of fails based on value over the past year
- Total volume of instructions settled by the CSD
- % of fails based on volume over the year.

The data should ideally contain figures for the past year and the previous year at a minimum, to allow for a comparison of the level of settlement efficiency over time.

Unlike in the case of reporting to regulators, for which ECSDA believes a single set of data should be used by all CSDs, we believe that for public reports it should be possible for a CSD to include additional information on top of the minimum required, or to update the information more frequently than once a year. This way, the level of disclosure could be adapted to local market characteristics (e.g. in small and concentrated markets, too granular information might not be appropriate if it allows to identify individual market participants).

Technical standards could require annual aggregate/anonymised settlement fails data to be made available on a dedicated page on the CSD's public website (not on a website with restricted access to CSD participants) or the public website of the respective competent authority.

5. Late settlement penalties – art.7(2)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 7(2): "For each securities settlement system it operates, a CSD shall establish procedures that facilitate settlement of transactions in financial instruments referred to in Article 5(1) that are not settled on the intended settlement date. These procedures shall provide for a penalty mechanism which will serve as an effective deterrent for participants that cause the settlement fails.

Before establishing the procedures referred to in the previous subparagraph, a CSD shall consult the relevant trading venues and CCPs in respect of which it provides settlement services.

Such penalty mechanisms shall include cash penalties for participants that cause settlement fails ('failing participants'). Cash penalties shall be calculated on a daily basis for each business day that a transaction fails to settle after its intended settlement date until the end of a buy-in period referred to in paragraph 3, but no longer than the actual settlement day.

The cash penalties referred to in the previous subparagraph shall not be configured as a revenue source for the CSD."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

"the processes for collection and redistribution of cash penalties and any other possible proceeds from such penalties"

WHAT THE LEVEL 2 EC DELEGATED ACT SHOULD SPECIFY:

"parameters for the calculation of a deterrent and proportionate level of cash penalties referred to in paragraph 2 based on asset type liquidity of the instrument and type of transaction that shall ensure a high degree of settlement discipline and a smooth and orderly functioning of the financial markets concerned."

ANNUAL REPORTING BY ESMA ON PENALTIES:

Article 74(1): "ESMA, in cooperation with EBA and the authorities referred to in Articles 10 and 12, shall submit annual reports to the Commission (...) [including] at least an assessment of the following:
(a) (...) settlement efficiency for domestic and cross-border operations for each Member State based on the number and volume of settlement fails, amount of penalties referred to in Article 7(4)(…)"
(b) appropriateness of penalties for settlement fails, in particular the need for additional flexibility in relation to penalties for settlement fails in relation to illiquid financial instruments referred to in Article 5(1)."

A. ECSDA Proposal

Although the ESMA Discussion Paper does not include a detailed analysis of the measures to be adopted under CSDR article 7(2) on penalties for late settlement, ECSDA expects that the European Commission will consult on its upcoming delegated act at a later stage. We thus seize this opportunity of this paper to describe what we think could constitute a workable system for late settlement penalties, consistent with the Level 1 text of the Regulation and with the other proposals made by ECSDA in relation with the Level 2 technical standards on settlement discipline. ECSDA stresses that these proposals are preliminary, and that we are committed to working jointly with ESMA, the European Commission and the other European associations representing users and market infrastructures to ensure that the future technical standards establish a workable framework for the processing of late settlement penalty fees. We also call on the European Commission and ESMA to

organise a proper market consultation on this aspect of the Regulation in the coming months, given the complexity of the issue and the need to ensure full consistency between the buy-in regime and the regime for late settlement penalties.

The upcoming EC delegated act on penalties for late settlement should:

1) Require that the penalty fee for late settlement be an **ad valorem fee with a fixed, per trade component** aimed to cover the costs of maintaining the penalty system;

2) **Determine a minimum amount for the fixed, per trade component of the penalty fee,** allowing CSDs to cover the costs of developing and maintaining the system. Some flexibility for CSDs to go beyond this minimum amount is however necessary to account for the different costs across CSDs.

3) Recommend a **mark-to-market approach** for determining the reference price on which to calculate the penalty (as this would ensure that a single method is used for sourcing reference prices for both DvP and FoP instructions), on the condition that (1) CSDs can obtain the required pricing data, that (2) ESMA specifies the source of prices to be used, possibly based on a tender, having in mind however that the cost of using this source by CSDs would be one of the costs of maintaining the penalty system, and that (3) a solution is found for illiquid securities for which no reliable daily market price is available;

4) **Exempt some FoP deliveries from penalties, such as transfers between securities accounts managed by the same participant** (including between the accounts of a participant and of an account holder that is not a participant in direct holding markets);

5) **Allow for a differentiated rate for calculating penalties for a maximum of two asset types, i.e. distinguishing between debt securities and transactions in all other financial instruments.** There should be a single daily penalty fee rate for both categories of transactions.

6) **Foresee the possibility for the calculation method to be adjusted over time** to reflect changing market conditions.

The upcoming EC delegated act should not:

7) **Impose the use of a gross (single-instruction-based) or multilateral net model to all CSDs.** CSDs should be allowed to choose either model. That said, a single model might be defined at the level of the T2S platform in the future if the Eurosystem ever decides to integrate a functionality facilitating the imposition of penalty fees by T2S participating CSDs.

The CSDR technical standards on the collection and redistribution of cash penalties should:

8) Require CSDs to redistribute the **penalty monies**, after having deducted the part used to cover the CSD's costs of maintaining the system, **whenever possible to the suffering party and, when this is not practical, to the community of participants** or to projects that benefit the market as a whole.

B. Analysis of the different options

(1) A proportional (ad valorem) penalty

ECSDA recognises that an ad valorem penalty fee for late settlement is generally fairer, and acts as a

better deterrent, than a "flat fee" system, even though we note that some CSDs today charge a flat fee on failed settlement instructions. In order to be workable, an ad valorem fee would however need to include a minimum fixed per trade component.

An ad valorem formula poses some challenges for **free of payment deliveries:**

- Some FoP deliveries should be exempt from penalties, such as transfers between securities accounts managed by the same participant[14] (mostly collateral movements, portfolio transfers, or transfers between a participant and another account holder who is not a participant for account allocation purposes in direct holding markets, see also our comments on compulsory matching).

- At the same time, other FoP deliveries are actually similar to DvP deliveries with the exception that the cash leg of the transaction settles outside the CSD (e.g. at an external cash settlement bank, a practice that is allowed and regulated by the CSD Regulation). Those transactions should consequently not be exempt from the general settlement discipline regime.

(a) A fixed amount charged for every failed instruction to cover CSD costs

CSDs must be able to recover their costs in relation to the setting up and management of the settlement discipline regime. A fixed, per trade component in the ad valorem fee would be a way to recover these costs, and to avoid that, in some cases, the cost of charging a penalty is higher than the amount of the penalty itself. Such "flat amount" is already applied in several markets today.

Level 2 legislation should therefore allow CSDs to establish a fixed, per trade component as part of the (otherwise ad valorem) penalty fee, and should specify a minimum monetary amount per trade. The possibility for a CSD to increase the amount of the fixed, per trade component, is important to reflect the different costs undergone by CSDs in developing and managing the settlement discipline regime. While the minimum amount will ensure a certain degree of harmonisation and ensure that CSDs can cover the costs of operating the discipline regime, individual CSDs facing higher costs and deciding to go beyond the minimum amount would have to consider the resulting competitive disadvantage.

(b) Conversion rate to be used in the calculation of penalty fees

For the sake of transparency and to avoid excessive costs and complexities, ECSDA recommends that the calculation method should be as simple as possible, avoiding for example daily changes in the rate of conversion used. We thus suggest using a simple rate applied to the reference value of the transaction with a fixed, per trade component to cover the CSD's costs.

Despite the need for simplicity, **a distinction is probably warranted between transactions in debt securities and all other transactions, given the typically higher average counter values of transactions in debt securities.** Such distinction is not widespread among CSDs, but some CSDs (e.g. Monte Titoli in Italy) have introduced a different rate for fixed income transactions at the request of their market participants. Distinguishing between more than two categories of transactions, however, would make the system too complex, and could considerably enhance costs.

In case the technical standards include a calculation formula for the late settlement penalty fee, we suggest the following characteristics:

[14] In some direct holding markets, account operators can be given a power of attorney to manage securities accounts registered in the name of another account holder. Transfers between such accounts, like transfers between accounts of the same participant, should be exempted from penalties.

- A proposed rate of 0.05% of the reference value for all transactions except debt securities, for which an appropriately calibrated (lower) rate is warranted;
- A harmonised minimum daily penalty fee of EUR X to be charged on each failed instruction (amount to be discussed with market participants);.
- A minimum fixed, per trade component of EUR 25 (or equivalent amount in the applicable currency) per daily penalty fee charged to cover the CSD's costs of managing the penalty regime.

It will also be very important that the rate can be calibrated over time to reflect changing market conditions. We strongly recommend that the technical standards foresee the possibility for regular reviews of the rate of conversion, the minimum daily penalty fee and the minimum fixed, per trade component, where necessary**, once the technical standards are in force.**

ECSDA is not in favour of incrementally increasing penalty rates as this would complicate the calculation. An ad valorem fee should anyways be sufficiently deterrent since it increases with the value of the instruction and with the length of the time the instruction remains unsettled.

(2) Reference price for the calculation of the ad valorem fee

If certain FoP transactions are included in the scope of the penalty regime, ECSDA believes that mark-to-market valuation would probably be the most appropriate option <u>provided the following conditions are met</u>:

- **Penalties are only applied to securities for which a reliable daily market price is readily available.** Today, most CSDs charging penalties for late settlement do not distinguish between "liquid" and "illiquid" securities. But in case of a mark-to-market approach, imposing penalties on illiquid securities for which a reliable daily market price is not available would increase risk and complexity.
- **CSDs would need to rely on the same, predetermined source of price information** to avoid any possible distortions or claims by participants that the reference price used for the calculation of the penalty is not correct. CSDs should be able to source price information easily and without being exposed to risks that this information might be inaccurate. ESMA should specify the source of prices to be used, possibly based on a tender, having in mind however that the cost of using this source by CSDs would be one of the costs of maintaining the penalty system.

The advantage of this option is that it would provide a single calculation method for both DvP and FoP instructions.

For instructions that fail to settle over multiple days, the penalty could be calculated based on the daily market price for each day when the settlement is delayed. Furthermore, although the calculation of penalty fees will be made on a daily basis, it should be possible for CSDs to charge the penalties to their participants on a monthly basis (e.g. in a special section of the invoice in the case of CSDs working with a monthly billing). This is in line with the current practice at some CSDs and would contribute to limit the administrative costs involved.

	Option A: Mark-to-market approach	**Option B: Monetary value of the settlement instruction**
Benefits	▪ A single method for all instructions (FoP, DvP) ▪ "Fairer"	▪ Easy to implement for the CSD
Disadvantages	▪ More risk (reliance on a third party provider for market prices, potential claims from participants	▪ Not appropriate for FoP deliveries ▪ Risk of wrong incentives (no penalties when the cash leg of the transaction

	if they believe the price to be inaccurate…) ▪ Higher costs for the CSD (use of data provider)	occurs outside the CSD system)
Conclusion	Appropriate	Not always appropriate

(3) Single instruction versus multilateral net balances

Level 2 legislation should not impose the use of a single model by CSDs, whether a "gross" model based on a single settlement instruction or a "net model" based on multilateral net balances for each security. Both models are currently in place and work efficiently at different CSDs. **ECSDA's preliminary analysis suggests that giving CSDs the choice between a gross and a net model should not result in significant distortions for market participants. Thus it should be up to each CSD to decide which model to apply after careful evaluation of the respective pros and cons.**

In the case of direct holding markets for instance, the 'gross' calculation model based on single instructions has the advantage of facilitating an accurate calculation of the penalty fees. Using multilateral net balances for calculating penalties could make the account allocation process much more complicated in such markets. Although in principle both the 'gross' and the 'net' models ensure a good level of "traceability" and transparency, some CSDs in direct holding markets feel that, with their current account set-up, the implementation of a net model would not always allow participants to see which individual instruction is linked to a penalty fee, making it more difficult for them to pass on the fees to the failing clients. This is because, in the "net" model, the CSD will only provide participants with the total amount of fees charged per ISIN.

On the other hand, compared to the "net" model, the "gross" model based on single settlement instructions has the disadvantage of imposing penalties onto some intermediaries which, in a chain of failed transactions, might have a "flat position" (i.e. they may be both receiver and payer of a penalty). A 'net' model avoids that such intermediary has to manage the "pass-on" of the penalties to its clients, and the related costs.

Both models can work with an RTGS system or a 'net' settlement system. Indeed, when penalties are calculated based on multilateral net balances, such calculation is independent from the settlement process.

In the future, ECSDA recognises that a single calculation model might need to be imposed at the level of the TARGET2-Securities platform if the Eurosystem ever decides to integrate a functionality facilitating the imposition of penalty fees by T2S-participating CSDs. Since the operator of T2S is unlikely to decide on such developments before the CSDR technical standards enter into force, **keeping both options open is important to avoid restricting T2S to the one option mandated by law.**

	Option A: "Gross" model	**Option B: "Net model"**	**Option C: Maintaining choice**
Benefits	▪ Since penalties are always linked to an individual instruction, it is easy for participants to identify to whom (among their own clients) they should "pass on" the cost of the penalty	▪ "Fairer" for those participants who cannot deliver because of another participant's fail (in a net system, they are not penalised) ▪ Possibly lower running costs for the CSD and	▪ Both systems are in use today and CSDs could continue working with the model most adapted to local market characteristics (e.g. direct holding)

	▪ More appropriate for direct holding markets ▪ Works well in complex & cross-border chains and in T2S, where it is not always possible for CSDs to easily identify the "first party in the chain" ▪ Positions the CSD as a neutral market infrastructure (not trying to identify the ultimate "responsible" in a chain of fails, given the limited information at the CSD's disposal) ▪ As it is the dominant model today, fewer CSDs will have to adapt their systems.	for participants, since the lower level of fines charged to participants reduces the processing cost ▪ Works both with an RTGS and a net settlement model (penalty calculation is an off-settlement process) ▪ Seems to better accommodate the exemption of CCPs from penalty fees (at least for those CCPs that use a continuous net settlement model).	
Disadvantages	▪ Less "fair" for participants because they are penalised even if they are not the first participant responsible for the fail in a chain of failed transactions, although they might receive compensation for the fail (as suffering party) ▪ Cumbersome for participants and CSDs given the higher running cost, since each and every fail gives rise to a penalty (and the related operational & administrative burden). However, it is not clear whether the cost differential will really be important, given that the "net" model also requires some special upkeeps / resources.	▪ Less widespread than the "gross" model, a net model would require important set-up costs for most CSDs. ▪ In case of a fail chain between multiple CSD participants, having to identify the first failing participant in the chain could prevent the CSD from automating its penalty mechanism. ▪ In direct holding markets, the "net model" is less transparent and could make the account allocation process more complex. For example, participants might have to make some adaptations to their systems to identify the penalties that need to be passed on to the underlying clients, given that they will only receive the "net" information from the CSD (a list with the amount of fees to be paid per ISIN)	▪ Risk of competitive advantage (or disadvantage) for those CSDs offering a "net" model?

		▪ Requires further discussion on some technical aspects such as H/R instructions and the use of omnibus accounts	
Conclusion	Not always appropriate	Not always appropriate	Appropriate

(4) Special cases

(a) Primary market transactions

ECSDA believes that primary market transactions require special consideration. In some (but not all) markets, such as the UK and Poland, new issues are exempted from penalties, at least for a certain number of days. That said, article 5(2) of the CSD Regulation exempts primary market transactions from the T+2 requirement, thereby already providing for some flexibility, and reducing the likelihood that penalties are charged:
"The intended settlement date shall be no later than on the second business day after the trading takes place. This requirement shall not apply to […] the first transaction where the transferable securities concerned are subject to initial recording in book-entry form pursuant to Article 3(2)."

(b) Repos and securities lending transactions

It is currently not possible for many CSDs – and it will not be possible for T2S – to identify bilateral repos and transactions resulting from bilateral securities lending and borrowing (SLB) arrangements**.** Exempting such transactions from the penalty regime would thus raise very concrete difficulties. Even if these CSDs were to be required to make technical changes to their system to allow participants to "flag" a bilateral repo or SLB transaction, the CSD would not be able to check the use made of such a flag – in other words, it is unclear how the system would be "policed", and there is a risk that some non-eligible instructions would be flagged as "repo" in order to avoid paying penalties, without any possibility for the CSD to know. The problem is due to the fact that, unlike in the case of SME growth shares, which ECSDA understands are to be exempted from penalty fees, and which can be identified by their ISIN code, repos and SLB can involve any type of financial instruments used as collateral, and thus not identifiable, unless the transactions occur in the context of the CSD's own triparty repo services, or centralise securities lending and borrowing service (in which case the CSD has access to information on the nature of the transaction).
As a result, ECSDA does not think that bilateral repos and securities lending transactions can be exempted from late settlement penalties. A general exemption for repos (especially bilateral repos) would be difficult, if not impossible, for most CSDs to implement.

(c) Illiquid securities

According to recital 16 of the CSD Regulation, the procedures and penalties related to settlement fails should be *"scaled in such a way that maintains and protects liquidity of the relevant financial instruments. In particular, market making activities play a crucial role in providing liquidity to markets within the Union, particularly to less liquid securities"*. We understand this to be a recognition of the complexity and risks involved in imposing penalties on the least liquid financial instruments. Indeed, in some cases, requiring CSDs to impose penalties illiquid securities could, in addition to entailing more risk for the CSD, further disincentivise market making for such instruments and, given that such securities are hard to borrow, further reduce their liquidity.

Limiting the penalty regime to liquid financial instruments, i.e. those securities for which a

reliable market price is readily available (meaning that the CSD receives at least daily prices), would also be consistent with the mark-to-market approach for calculating the penalty fee as for illiquid securities no "fresh" market price is usually available.
Moreover, it should also be taken into account that illiquid securities will be subject to an extended buy-in period, according to CSDR article 7(4)(a), so that late settlement fees would be applied for a longer timeframe than in the case of liquid securities.

Exempting illiquid securities from late settlement penalties will however require a clear, harmonised definition of what "illiquid" means for securities settlement purposes. ECSDA notes that the approach used by ESMA to define "liquidity" in the context of EMIR (EC delegated regulation 149/2013, Article 7) is too CCP- and derivative-specific and cannot be applied in the context of securities settlement. Nonetheless, the *"availability of fair, reliable and generally accepted pricing information",* a notion contained in EMIR (Article 5(4) of Regulation (EU) No 648/2012), will be relevant should a mark-to-market approach be adopted for the calculation of CSD late settlement penalties.

According to CSDR Recital 16, in the context of buy-ins, *"the basis for determining when financial instruments are deemed to be illiquid should be established through regulatory technical standards, taking account of the assessments already made in Regulation [MiFIR]."* ECSDA draws two conclusions from this Recital:

- First, that the definition of "liquid market" under MiFIR Article 2(17)[15] can be used as a basis to develop an appropriate definition of liquidity for the purpose of settlement discipline. The definition, however, does not have to be exactly the same;
- Second, ESMA should ideally propose a definition of liquidity that is relevant both in the context of buy-ins and in the context of penalties for late settlement.

For a definition of "liquid financial instruments" to be workable from a settlement discipline perspective, ECSDA believes it is indispensable that CSDs, at any time, can obtain easily and at minimal cost information on whether a given financial instrument is considered "illiquid" or "liquid", and that (at least) daily prices for this instrument are readily available from data vendors.

	Option A: Exempting "illiquid" securities from penalties	**Option B: Include all securities instructions in the penalty regime**
Benefits	▪ Consistent with the aim of protecting and maintaining liquidity contained in CSDR Recital 16 ▪ Reduces risk for the CSD since no daily market price is readily available and the calculation of the penalty fee would thus involve complex (and	▪ Easier for CSDs to automate the process (penalties apply to all types of instruments) ▪ Given that a substantial proportion of fails is due to less liquid securities (fails on blue chip stocks, on the other hand, tend to be relatively low),

[15] "*(17) 'liquid market' means:*
(a) for the purposes of Articles 9, 11, and 18, a market for a financial instrument or a class of financial instruments, where there are ready and willing buyers and sellers on a continuous basis, and where the market is assessed in accordance with the following criteria, taking into consideration the specific market structures of the particular financial instrument or of the particular class of financial instruments:
(i) the average frequency and size of transactions over a range of market conditions, having regard to the nature and life cycle of products within the class of financial instrument;
(ii) the number and type of market participants, including the ratio of market participants to traded financial instruments in a particular product;
(iii) the average size of spreads, where available;
(b) for the purposes of Articles 4, 5 and 14, a market for a financial instrument that is traded daily where the market is assessed according to the following criteria:
(i) the free float;
(ii) the average daily number of transactions in those financial instruments;
(iii) the average daily turnover for those financial instruments."

	potentially contested) choices ▪ Illiquid securities are typically hard to borrow, and not penalising them for late settlement avoids further dis-incentivising investments in such instruments (including e.g. SME growth shares) ▪ The role of market makers is often important for such instruments, and imposing heavy penalties could discourage market making and further reduce liquidity	including such securities in the penalty regime would very likely have a stronger impact on the overall settlement efficiency rate.
Disadvantages	▪ Introduces more complexity in the penalty system and reduce possibility to automate, especially since a given instrument can go from being "liquid" to "illiquid" over time and vice-versa (no possibility to include/exclude certain ISINs on a permanent basis)	▪ Makes illiquid securities (including potentially SME growth stocks) even less attractive to trade in, including market-making activities in such securities ▪ Inconsistent with CSDR Recital 16 requiring a calibrated regime which takes into account the liquidity of securities ▪ Difficulty to calculate penalties on securities for which no reliable price is available, risk of wrong valuations and claims towards the CSD

In order to take into account the costs for the CSD of recycling failed delivery instructions in illiquid securities, **ESMA might however consider whether to apply the minimum fixed daily amount to such failed instructions in illiquid securities**. Such minimum fee would not involve any ad valorem calculation but could serve to avoid 'wrong incentives' and to cover the CSD's costs.

(5) Penalties in the context of cross-CSD settlement

According to the Level 1 text of the CSD Regulation, article 7(11), late settlement penalties *"shall not apply to failing participants which are CCPs."* There is no such exemption, however, for CSDs acting as participants in other CSDs ("investor CSDs" in the context of CSD links).

We note that, in line with the Level 1 Regulation, **only CCPs which are direct participants in a CSD will be exempted from penalty fees. In the case of "indirect links" (i.e. when a CCP accesses a CSD via an intermediary, without being a CSD participant), penalties will apply.**

In a cross-CSD settlement situation, ECSDA understands that the investor CSD will be fined for fails like any other participant, and will subsequently be expected to pass on the fine to its own participant(s) having failed to deliver on time. **The fact that CSDs are part of the T2S platform or have an interoperable link with (an)other CSD(s) should not have an impact on the way penalties are applied.** Generally, CSDR technical standards should not introduce any distinction between CSDs that are part of T2S and other CSDs. Penalties should apply to all CSDs in the same way.

That said, we expect that some issues will need to be addressed at the technical level in TARGET2-Securities to ensure that the process of "passing on" penalties from one CSD to another can work.

Irrespective of T2S, the following aspects will have to be clarified for an efficient processing of penalty

fees in a cross-CSD context:

- Based on current bookkeeping regulations, it is unclear **whether the penalties would be considered as the CSD's own assets or clients' assets.** We assume that an efficient processing will usually require penalties to be treated as CSD assets by the investor CSD, so that they are easy to charge and refund to CSD participants as part of the CSD's monthly invoicing. We expect such matters to be determined as part of the agreement between the issuer CSD and the respective investor CSDs.
  If an investor CSD is charged penalties by an issuer CSD because of fails by one of its participants, we remark that the investor CSD might have to pay the issuer CSD even before it gets paid by the failing participant, thereby being temporarily exposed to the failing participant. In this context, the implications in case of an insolvency of a CSD participant must be clarified. Liabilities of an investor CSD must be limited and unambiguous in a T2S (and non-T2S) cross-border settlement context.
- If an investor CSD is charged penalties by an issuer CSD because of fails due to a 'glitch' in the system of the investor CSD, we assume that the investor CSD will have to pay the fee out of its own assets.

(6) Possibility to collect penalties only beyond a certain threshold

The objective of a settlement discipline scheme is to maintain a high level of settlement efficiency. This is why, in some existing penalty schemes, CSDs only penalise failed transactions when the fail rate of a given participant falls below a certain threshold (e.g. DK, UK). This "threshold" is a benchmark; it represents the target settlement efficiency rate each market participant should seek to achieve on an ongoing basis at a minimum.

ECSDA believes that the use of a threshold/benchmark can be a good way to ensure that penalties fulfil their aim, i.e. to support overall settlement efficiency in a market, rather than to penalise each and every fail. However, **in case the CSDR technical standards foresee the possibility for CSDs to restrict the collection of penalty fees to those cases a threshold is not met, it is important that the same threshold applies for all EU markets.** ESMA should thus, if applicable, specify how such a threshold is determined. It could be either a fixed percentage, e.g. 95% of settled instructions on the intended settlement date (but then this figure must be easy to adjust over time) or a more flexible formula, such as the average settlement efficiency rate in a given market.

ECSDA does not recommend giving each CSD the choice as to whether or not a performance threshold is used (and how it is determined) as this could result in competitive distortions.

Where a threshold is used, it should ensure that it is possible for CSD participants to associate fines with the underlying transactions – practically, this means that if performance drops below a certain threshold, then all fails will be fined for that participant, not just some.

We note that allowing for a 'threshold approach' would require the following issues to be addressed:

- In case of a fail which is below the threshold, a CSD still has to process the fail and report it, which generates costs for the system. When no penalty is charged, the CSD cannot cover these costs;
- Implementing a threshold is likely to make the penalty system more complex and thus costly to manage;
- Thresholds are acceptable when there is no necessity to pass the penalty fee to the suffering party. However when the penalties are 'passed on', suffering parties risk not obtaining compensation when 'their' fails fall below the threshold;
- A penalty system should be transparent and predictable. The disadvantage of such "thresholds" is that they somewhat reduce the predictability of the system.

(7) Use of the penalty monies

ECSDA agrees that penalties exist to promote settlement efficiency and should not be a source of income for the CSD. Today, such penalties are a revenue source for CSDs in a few countries, and so the Regulation will result in an important change in these markets.

However, **CSDs should be allowed to retain part of the penalty monies to recover the cost of managing the procedure (primarily communication and administrative costs)**. It is not possible to specify in technical standards the exact proportion of the collected fees that should be used to cover the costs of maintaining the penalty system versus the proportion that should be "redistributed", since this will depend on various factors (the overall level of fails, the level of the penalties charged, the number of participants, the way penalties are billed by the CSD as well as the level of complication of the system resulting from the ESMA technical standards). Today, some CSDs retain more than 50% of the collected penalties to maintain the system, while others retain a smaller portion (around 10%). Other CSDs charge a flat administrative fee to cover their costs while redistributing to rest to the participant having "suffered" from the fail. **In the future, the use of a minimum fixed, per trade component in the ad valorem fee could be a good way to allow CSDs to recover the costs of operating the penalty system.**

In order for the harmonised penalty regime to work efficiently in all EU markets, technical standards should include the following rules:

- **CSDs should be allowed to use part of the penalty monies to cover the costs of maintaining the penalty regime;**
- **The remainder of the monies should be allocated whenever possible to the suffering party and, when this is not practical, to the community of participants or to projects that benefit the market as a whole.**

In general, we note however that the CSD can pass on the penalty fee only to the receiving participant. This does not ensure that the actual suffering party receives the payment, which will mostly be an underlying client of the participant (or even further down the chain).

In terms of the "timing" for the redistribution of penalty monies, we assume that CSDs will wait for the penalties due by failing participants to be paid before the corresponding redistribution to the suffering participants can be executed. This would avoid a situation where investor CSDs have to refund penalties out of their own assets, thereby becoming exposed to the failing participants.

6. Buy-ins – art.7(3) to (8)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 7(3): "Without prejudice to the penalties as defined in paragraph 2 and the right to bilaterally cancel the transaction, where a failing participant does not deliver the financial instruments referred to in Article 5(1) to the receiving participant within 4 business days after the intended settlement date ('extension period') a buy-in process shall be initiated whereby those instruments shall be available for settlement and delivered to the receiving participant within an appropriate time frame. Where the transaction relates to a financial instrument traded on an SME growth market the extension period shall be 15 days unless the SME growth market decides to apply a shorter period."

Article 7(4): "The following exemptions from the requirement referred to in paragraph 3 shall apply:
a) Based on asset type and liquidity of the financial instruments concerned, the extension period may be increased from 4 business days up to a maximum of 7 business days where a shorter extension period would affect the smooth and orderly functioning of the financial markets concerned.
b) For operations composed of several transactions including securities repurchase or lending agreements, the buy-in referred to in first sub-paragraph shall not apply where the timeframe of these operations is sufficiently short and renders the buy-in ineffective.

Article 7(5): "Without prejudice to paragraph 4, the exemptions referred to in paragraph 3a0 shall not apply in relation to transactions for shares where the shares are cleared by a CCP.
This Article does not apply where the principal venue for the trading of shares is located in a third country. The location of the principal venue for the trading of shares is to be determined in accordance with Article 16 of Regulation 236/2012."

Article 7(6): "Without prejudice to the penalties as defined in paragraph 2, where the price of the shares agreed at the time of the trade is higher than the price paid for the execution of the buy-in, the corresponding difference shall be paid to the receiving participant by the failing participant no later than on the second business day after the financial instruments have been delivered following the buy-in.]"

Article 7(7): "If the buy-in fails or is not possible, the receiving participant can choose to be paid a cash compensation or to defer the execution of the buy-in to an appropriate later date ('deferral period'). If the financial instruments are not delivered to the receiving participant at the end of the deferral period, the cash compensation shall be paid.
The cash compensation shall be paid to the receiving participant no later than on the second business day after the end of the buy-in period or deferral period, where the deferral period was chosen."

Article 7(8): 'The failing participant shall reimburse the entity that executes the buy-in of all amounts paid in accordance with paragraphs 3, 4 and 5, including any execution fees resulting from the buy-in. Such fees shall be clearly disclosed to the participants.'

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

"c) the details of operation of the appropriate buy-in mechanism, including appropriate time frames to deliver the financial instrument following the buy-in procedure referred to in paragraph 3. Such time frames shall be calibrated taking into account the asset type and liquidity of the financial instruments.
d) the circumstances under which the extension period could be prolonged according to asset type and liquidity of the financial instruments, in accordance with the conditions referred to in point (a) of paragraph 4 taking into account the criteria for assessing liquidity under Articles 2(1)(7a) of MiFIR [MIFIR determination of 'liquid market'];

e) type of operations and their specific timeframes referred to in point (c) of paragraph 4 that renders buy-in ineffective;
f) A methodology for the calculation of the cash compensation referred to in paragraph 7."

ANNUAL REPORTING BY ESMA ON BUY-IN:

Article 74(1): "ESMA, in cooperation with EBA and the authorities referred to in Articles 10 and 12, shall submit annual reports to the Commission (...) [including] at least an assessment of the following:
(a) (...) number and volumes of buy-in transactions referred to in Article 7(4) and any other relevant criteria."

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?

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?

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?

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

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

Today, CSDs are typically not involved in the buy-in process, which, as recognised by the CSD Regulation, is primarily the responsibility of CCPs. Nonetheless, in the case of "pure" OTC transactions (i.e. transactions not executed on recognised trading venues and not cleared by a CCP), Article 7(10)(c) foresees that *"the CSDs shall include in their internal rules an obligation for its participants to be subject to [buy-ins]".*

In this respect, ECSDA believes that CSDs, given their low risk profile, should in principle not be involved in the execution of buy-ins. Furthermore, buy-ins are about the enforcement of contractual obligations at the trading level, and it is unclear how such a process can be "policed" at the settlement level, even if the rules on buy-ins are contained in CSDs' rulebooks. ECSDA thus recommends that further discussions should take place between ESMA, market infrastructures and their users, after the consultation deadline of 22 May, to consider what processes could be put in place to enforce the CSDR buy-in rules in 'non-CCP' scenarios. Given that it is not possible for CSDs to police the execution of buy-ins, we believe it is important to bring clarity on 'who is responsible for what', and we are committed to working jointly with the other European associations representing users and market infrastructures to try and develop a workable solution by mid-July in order for ESMA to take it into account when drafting the actual technical standards on buy-ins.

Finally, in line with our comments on the application of late settlement penalties on illiquid securities, we support a proper calibration of the buy-in procedure to take into account the constraints in relation to the liquidity of securities. In particular, highly illiquid securities should be subject to longer timeframes for delivery to the receiving participant.

7. Suspension of failing participants – art.7(9)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 7(9): "CSDs, CCPs, trading venues shall establish procedures that enable them to suspend in consultation with their respective competent authority any participant that fails consistently and systematically to deliver the financial instruments referred to in Article 5(1) on the intended settlement date and to disclose to the public its identity only after giving that participant the opportunity to submit its observations and provided the competent authorities of the CSD, CCPs and trading venues, and of that participant have been duly informed.
In addition to consulting before any suspension, CSDs, CCPs and trading venues, shall notify, with no delay, the respective competent authority of the suspension of a participant. The competent authority shall immediately inform the relevant authorities referred to in Article 11 on the suspension of the participant.
Public disclosure of suspensions shall not contain personal data within the meaning of Article 2 (a) of Directive 95/46/EC.".

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

"the conditions under which a participant is deemed to consistently and systemically fail to deliver the financial instruments referred to in paragraph 9"

A. ECSDA Proposal

Given the serious consequences the suspension of a CSD participant can have for financial markets as a whole, this measure should be considered only as the ultimate punishment in extreme cases and always involve close coordination with the competent authority. A quantitative threshold should in any case:

- be reasonably low (e.g. below 75% of instructions settled on the intended settlement date, in volume or value, over a 12-month period), and
- never automatically trigger the suspension of a participant.

B. Analysis of the different options

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).

ECSDA generally agrees with the approach suggested by ESMA in paragraphs 64 to 66 of the Discussion Paper. However we believe that the suspension of a participant should be considered as an extreme measure. It can only be used as an ultimate solution to a serious problem, and will only be implemented after careful consideration of the circumstances of each case.

First of all, in many cases where a CSD participant fails to deliver securities, the fail is not due to the participant itself but to its underlying client(s). Given that in most cases the CSD can neither identify nor suspend the underlying client with whom it has no direct contractual relationship, suspending the participant will not effectively solve the problem. A less extreme alternative that addresses this constraint is for instance applied in Norway. In case of major problems, VPS, the Norwegian CSD, has

the possibility to put a restriction on failing participants that forces them to identify the underlying client(s) that have caused the repeated fails. In practice, it means that the participant can no longer accept settlement instructions from this (these) client(s) if it wishes to remain a participant in the CSD. The suspension of the participant itself is thus the ultimate step in case the participant fails to comply with this condition.

Second, expecting a CSD to suspend a participant repeatedly failing to settle on time would imply that the CSD can trigger the suspension of a participant from all relevant trading venues and CCPs. Since this is not the case, we do not believe that a suspension is a reasonable response to repeated settlement failure and that there are other more efficient ways for the CSD to penalise repeated bad behaviour.

Keeping in mind that the suspension of a participant is a measure to be only considered in extreme scenarios, and in very close consultation with supervisory authorities and the other infrastructures involved, ECSDA acknowledges that ESMA might need to establish a threshold (or a combination of two thresholds, to take into account the value and volume of fails) to help define the notion of a participant failing "*consistently and systematically*". **Based on current experience, we believe that the threshold should in any case not be higher than 75% instructions settled on the intended settlement date (in terms of volume or value), and should be calculated over a sufficiently long period, e.g. 12 months.**

Most importantly, even if one or more thresholds are included in technical standards, it should be clear that **the suspension of a participant should never be triggered automatically once the thresholds are reached.** Some degree of discretion is needed for the CSD to consult with regulators and assess the possible consequences of a suspension for systemic risk.

8. Settlement information necessary for executing buy-ins – art.7(10)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 7(10): "Paragraphs 2 to 9 shall apply to all transactions of the instruments referred to in Article 5 (1) which are admitted to trading or traded on a trading venue or cleared by a CCP as follows:
a) For transactions cleared by a CCP, the CCP shall be the entity that executes the buy-in procedure according to paragraphs 3 to 4a.
b) For transactions not cleared by a CCP but executed on a trading venue, the trading venue shall include in its internal rules an obligation for its members and its participants to be subject to the measures referred to in paragraphs 3 to 8.
c) For all other transactions than those referred to in points (a) and (b) the CSDs shall include in their internal rules an obligation for its participants to be subject to the measures referred to in paragraphs 3 to 8.

A CSD shall provide the necessary settlement information to CCPs and trading venues to enable them to fulfil their obligations under this paragraph.

Without prejudice to points (a) to (c) of this sub-paragraph CSDs may monitor the execution of buy-ins referred to in those points with respect to multiple settlement instructions, on the same financial instruments and with the same date of expiry of the execution period, with the aim of minimising the number of buy-ins to be executed and thus the impact on the prices of the relevant financial instruments.

Paragraphs 2 to 6 shall not apply to failing participants which are CCPs."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

"the necessary settlement information referred to in paragraph 10"

A. ECSDA Proposal

Technical standards should:

1) Require CSDs to inform CCPs and/or, where appropriate, trading venues about the current status of instructions received from these CCPs/trading venues. The information to be provided should be specified in the transaction feed agreement signed between the relevant infrastructures, if applicable.

Technical standards should not:

2) Impose the segregation of the accounts of all trading and clearing members at CSD level.

B. Analysis of the different options

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 out-lined above? If not, please explain what alternative solutions might be used to achieve the same results.

ECSDA has strong reservations about the analysis and the proposals made by ESMA in paragraphs 68 and 69 of its Discussion Paper. In particular, we do not agree with the statement that CSDs *"need to be able to associate the activity of each clearing member, CCP and participant to a trading venue, to a given securities account"*. In fact, we believe that it is the entity responsible for executing the buy-

in (e.g. the CCP), which needs to be able to link a failed settlement instruction to a given counterparty.

As far as buy-ins of CCP-cleared transactions are concerned, the processes currently in place are satisfactory: CCPs are able to access the information they need to effect buy-ins and the information is passed on, where relevant, to trading members (irrespective of whether these act as clearing members or CSD participants). CCPs obtain the required information either through direct participation in the CSD or through indirect participation via a CSD participant. **A requirement to segregate the accounts of clearing members at CSD level is thus unnecessary, and unlikely in itself to solve the problem of buy-in execution.**

Unlike CCPs, trading venues are typically not participants in CSDs and thus might not have access to as much information on the settlement of transactions as CCPs. That said the Level 1 Regulation requires a trading venue to *"include in its internal rules an obligation for its members and its participants to be subject to the [buy-in] measures referred to in paragraphs 3 to 8."* It does not require trading venues to execute buy-ins on behalf of participants that have suffered from a fail, but only to foresee a buy-obligation in its rules. It is thus not entirely clear what kind of settlement information trading venues would need to receive from CSDs for the purpose of complying with CSDR article 7(10).

In the absence of a CCP, it is unclear "who" is responsible for effecting a buy-in since the trading counterparties (which are subject to the buy-in) are rarely CSD participants and have no contractual relationship with the CSD.

That said, we note that where a CSD receives a transaction feed directly from a trading venue, it is in principle able to send back to the trading venue the necessary information to manage the buy-in with reference to the trading counterparty (even when the trading counterparty is not a CSD participant but appoints a CSD participant to act as its settlement agent). In this regard, it should be considered that both CSDR and the revised MiFID establish a regulatory framework facilitating access to transaction feeds. Such feeds will typically be covered by a contractual agreement between a trading venue and the relevant 'linked' market infrastructures. The information flow to be provided for the purpose of executing buy-ins could thus be specified in these agreements, if applicable at all.

It is unclear whether requiring a trading member or a clearing member to open a separate account at the CSD, segregated from other trading or clearing members holding securities with the same CSD participant, would solve this problem. The requirement to open such segregated accounts would anyways fall on the market participants, and cannot be imposed on the CSD itself, so it seems that such a requirement would go beyond the scope of the Level 1 mandate in CSDR article 7.

A further segregation requirement introduced in Level 2 standards would very likely result in a sharp increase in the number of securities accounts maintained at CSD level, which would be costly and could result in capacity problems at some CSDs. Given the limited use of such accounts for the purpose of enforcing buy-ins, and in view of the implied costs, **ECSDA is convinced that CSDR technical standards should not impose segregation requirements on trading and clearing members.**

	Option A: Mandatory segregation requirements for trading and clearing members at CSD level	**Option B: Requirement for CSDs to pass to CCPs and trading venues the information on the current status of instructions received from these infrastructures**
Benefits	▪ Very limited in the case of CCPs,	▪ Easy to employ (part of standard

	which have well-established procedures in place and already have access to all relevant information from the CSD to manage the buy-in procedure.	reporting, at least in some CSDs). The information passed on would enable a CCP or trading venue to determine the date when the buy-in should be effected.
Disadvantages	▪ Unnecessary proliferation of accounts at CSD level would be costly and could lead to capacity problems in some CSDs.	
Conclusion	Not appropriate	Appropriate

Finally, we note that, when applying a buy-in at the trading venue level, there is a risk that some settlement optimisation mechanisms between on-exchange and OTC transactions at the CSD level could be prevented.

9. Timeline for implementing CSDR article 7

TIMING BY "DEFAULT", BASED ON THE LEVEL 1 REGULATION:

Technical standards under CSDR Article 7 would, unless special transitional provisions are foreseen, enter into force 20 days after their publication in the Official Journal.

ECSDA, together with the major stakeholders in the securities industry, is very concerned about the timing of article 7 implementation. As explained in our Introductory remarks, both CSDs and their users will have to make important adaptations to their IT systems in order to comply with the future settlement discipline requirements. Such adaptations can only be initiated once the technical standards are final and the detailed specifications are known. As a result, ESMA and the EU legislator should be aware that it is not realistic to expect CSDs to comply with Article 7 requirements within 20 days after the entry into force of the new rules in the Official Journal of the European Union.

Based on past experience (some of which is described in more detail in the response of the T2S Advisory Group to the ESMA consultation) and on ESMA's current proposals, **ECSDA expects that the changes required of CSDs (e.g. database changes, introduction of new messages, new billing mechanism…) will take many months to implement.**

It is in the interest of securities regulators and policy makers that the adaptations are not rushed and that CSDs have sufficient time to follow best project management practices, especially to avoid any negative impact on the preparations for TARGET2-Securities implementation. Once the technical specifications are known, CSDs will probably need at least 12 months to develop the required IT functionalities and to test the system, first internally, and later with market participants.

ECSDA thus strongly recommends that ESMA should consider a transition period of up to 3 years (from 2015 to 2017) for achieving full implementation of CSDR article 7.

Assuming that the technical standards are adopted in final form prior to the launch of T2S in June 2015, we are convinced that a phased implementation until 2017 (by the time of the 4th T2S migration wave) would minimise the risk of disturbances and benefit the whole market by allowing for a smooth transition to the new framework.

Finally, it is important that this timeline is complemented by adequate transitional provisions that take into account all related EU regulatory initiatives (e.g. Short Selling Regulation which is subject to a deletion according to Article 72a).

Annex 2

A new framework for CSD authorisation and supervision

This paper constitutes the second part of ECSD's comments on the ESMA Discussion Paper of 20 March 2014 on draft technical standards for the CSD Regulation ("CSDR"). It covers questions 21 to 54 of the consultation, which primarily relate to the authorisation framework for CSDs.

Executive Summary

- Technical standards under the CSD Regulation should not be considered as 'minimum requirements' for competent authorities. **The imposition of additional requirements ('on top of' the European rules) by national regulators should be avoided as much as possible** to ensure truly equal conditions of competition for CSDs and truly harmonised safety standards across EU markets. National regulators should not be allowed to 'gold-plate' technical standards and require CSDs to maintain, for example, additional data items as part of their record-keeping obligation compared to CSDs operating similar activities in other EU countries.

- That said, **harmonised standards do not equal a "one-size-fits-all" approach and it should be possible for European technical standards to be implemented proportionately, taking into account the diversity in CSD business models, activities and size.** For instance, requirements covering the compliance function, the audit function, and the risk function in CSDs, should not mean that smaller CSDs have to appoint a staff member exclusively dedicated to each of these functions. It should be possible, instead, for these functions to be combined with other roles. For example, the same person will often act both as legal counsel and compliance officer for the CSD. In the case of corporate groups, it should be possible for an individual to perform one of these functions for different entities within the group.

- **The ongoing supervisory assessments to be carried out based on the CSDR technical standards should build on, and avoid duplication with, assessments under the CPSS-IOSCO Principles for financial market infrastructures, and Eurosystem assessments, including for CSD links.** We also expect that the former ESCB-CESR standards will be discontinued and replaced by the CSDR technical standards.

- **The recordkeeping requirements currently envisaged by ESMA are unnecessarily extensive and should be substantially reviewed to avoid imposing unnecessarily high costs on CSDs and their users.** Based on information collected from 18 European CSDs, and assuming that the proposed ESMA requirements would all have to be implemented, it is anticipated that the system development costs for the 33 CSDs in the European Economic Area would exceed EUR 75 million, possibly even EUR 115 million. The mandatory use of Legal Entity Identifiers (LEI) and of non-proprietary format for CSD records, in particular, would be extremely costly to implement.

- **Moreover, the purpose for CSD recordkeeping requirements should be clarified and CSDs should not be confused with "trade repositories".** In line with the CSD Regulation, rules on recordkeeping should primarily aim at allowing regulators to assess compliance with CSDR, and they are not meant to provide regulators with transaction data allowing them to oversee the activities of market participants. The list of compulsory recordkeeping items should be reduced accordingly, a more balanced approach must be found.

- CSDs will have to make important technical adaptations to their systems in order to comply with some of the most complex technical standards. It is thus indispensable for ESMA to recognise that CSDs will not realistically be able to demonstrate compliance with all technical standards during the initial authorisation process. **An appropriate transition period must be foreseen, at least for the following standards:**

  - **Settlement discipline:** CSDs, market participants and other infrastructures should be given at least three years to comply with the new rules on buy-ins and penalties for late settlement, to be adopted under CSDR article 7;

  - **Recordkeeping:** Depending on the scope of the final requirements, a transition period of at least 14 months will have to be determined to allow CSDs to develop the required functionalities;

  - **Requirements on a secondary processing site:** CSD having to set up a new secondary processing site should be given at least 6 months after the entry into force of the technical standards to achieve compliance.

- **Technical standards should ensure that the recognition of third country CSDs under CSDR is not just a one-off approval, but an ongoing process.** Once a third country CSD is recognised, follow-up arrangements should be in place to ensure ongoing supervisory equivalence.

- **Finally, for CSDs with a banking licence, ESMA should anticipate possible overlaps and avoid whenever possible inconsistencies between CSDR technical standards and applicable banking legislation (CRD IV and CRR in particular[1]).**

[1] CRD IV refers to the Directive 2013/36/EU and Regulation (EU) No 575/2013 on capital requirements for banks.

1. Internalised settlement - Article 9(2), (3)

WHAT THE LEVEL 1 REGULATION SAYS:
Article 9(1): **"**Settlement internalisers shall report to the competent authorities the aggregated volume and value of all securities transactions that they settle outside securities settlement systems on a quarterly basis. Competent authorities shall without delay transmit the information received under the first subparagraph to ESMA and shall inform ESMA of any potential risk resulting from that settlement activity."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 9(2): RTS on "the content of such reporting"
Article 9(3): ITS "to establish standard forms, templates and procedures for the reporting and transmission of information referred to in paragraph 1"

ANNUAL REPORTING BY ESMA ON INTERNALISED SETTLEMENT:

Article 74(1): "ESMA, in cooperation with EBA and the authorities referred to in Articles 10 and 12, shall submit annual reports to the Commission (...) [including] at least an assessment of the following:
(c) measuring settlement which does not take place in the securities settlement systems operated by CSDs based on the number and volume of transactions and any other relevant criteria based on the information received under Article 9".

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

We do not wish to comment on the requirements for "settlement internalisers", as this is not generally an issue for CSDs.

Nonetheless, we suggest that ESMA should avoid referring to "transfer orders", since this term has a meaning specific to the Settlement Finality Directive (SFD), and should rather use the term "settlement instruction", which we believe is more appropriate in the context of settlement internalisation.

2. Information provided to the authorities for authorisation - Article 17(8), (9)

WHAT THE LEVEL 1 REGULATION SAYS:
Article 17(1): "The applicant CSD shall submit an application for authorisation to its competent authority."
Article 17(2): "The application for authorisation shall be accompanied by all information necessary to enable the competent authority to satisfy itself that the applicant CSD has established, at the time of the authorisation, all the necessary arrangements to meet its obligations set out in this Regulation. The application for authorisation shall include a programme of operations setting out the types of business envisaged and the structural organisation of the CSD."
Article 17(3): "Within 30 working days from the receipt of the application, the competent authority shall assess whether the application is complete. If the application is not complete, the competent authority shall set a time limit by which the applicant CSD has to provide additional information. The competent authority shall inform the applicant CSD when the application is considered to be complete."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 17(8): RTS on "the information that the applicant CSD shall provide to the competent authority in the application for authorisation"
Article 17(9): ITS on "standard forms, templates and procedures for the application for authorisation."

Q22: Would you agree that the elements above and included in Annex I are appropriate? If not, please indicate the reasons or provide ESMA with further elements which you find could be included in the draft RTS, and any further details to justify their inclusion.

We agree with the general 'building blocks' contained in Annex 1 of the ESMA Discussion Paper, while noting that the information that CSDs are required to provide for authorisation is very extensive. We agree with ESMA's statement, in paragraph 79, that the application of a CSD *"should include all details needed to demonstrate compliance with all CSDR and relevant technical standards"*.

However, we do not think that CSDs can realistically be expected to comply with the technical standards under Title II of the CSD Regulation, especially as regards settlement discipline measures (CSDR article 7), by the time they file their application with their competent authority. Indeed, as outlined in part 1 of our comments on the ESMA Discussion Paper[2], and in line with the joint industry letter sent to the co-legislators on 4 November 2013[3], details of the future settlement discipline regime will not be known until Level 2 legislation is adopted in 2015 and the changes required of CSD systems will take months to implement. Moreover, these changes will have to be reflected by CSD participants so that they can pass on fines to their own clients, if appropriate. Given the additional complexity of having to implement these changes in parallel with the migration to TARGET2-Securities for many EU CSDs participating in the project, a transition period is necessary to make the necessary adaptations. **We thus ask ESMA to clarify that the items listed under points E2 and E3 of Annex I of the Discussion Paper (intended settlement dates, preventing fails and measures to address settlement fails) will not be required for a CSD to obtain authorisation, at least in the first three years after the Level 2 standards on settlement discipline have been adopted.**

A similar approach, but with a presumably shorter transition period, should be adopted for points C7 on recordkeeping and F3(2) as regards CSD secondary processing sites (see more detailed explanations in our responses to questions 28 and 39).

We also suggest that points 8 and 9 under C2.8 (Internal Control Mechanisms) in Annex I could be removed as they seem to duplicate with the information required under A2.2 (Policies and procedures).

Furthermore, **we do not think that the information specified by ESMA under article 17(8) and detailed in Annex 1 of the Discussion Paper should be described as "minimum requirements".** Given that the proposed requirements are already very detailed and extensive, and given the need to ensure a consistent and fair application process for all CSDs across the European Union, the contents required of CSD applications should be the same in all jurisdictions, and it should not be possible for national regulators in certain countries to 'gold-plate' the ESMA requirements and ask for more information than would have been required by another national regulator in a different jurisdiction. Since the Level 1 text does not refer to "minimum" requirements, we suggest that ESMA should avoid this term in the technical standards and design instead a single, harmonised list of elements to be contained in CSDs' application documents.

That said, given the diversity of CSD business models and service offers, it should be noted that not all the required items listed in Annex I will be relevant and appropriate for all CSDs, in particular given that not all CSDs will be authorised for the full set of core and ancillary services. The technical standards should thus recognise that, if a CSD does not intend to provide a specific service (or e.g. if it does not plan to establish any link with other CSDs), it should not be required to provide the corresponding information to the competent authority.

[2] See http://www.ecsda.eu/position_papers.html
[3] See http://www.ecsda.eu/joint_papers.html

We also believe that CSDs should be allowed to leverage, where appropriate, on the extensive information provided as part of their yearly disclosure or self-assessment reports under the CPSS-IOSCO Principles for financial market infrastructures (PFMI) in order to demonstrate compliance with the CSDR. We recognise that the CSDR authorisation process will be a one-off exercise, separate from the ongoing supervisory assessment of CSDs, but we also believe that existing assessments and disclosure reports can form a valuable basis for demonstrating compliance with the authorisation requirements under CSDR. Allowing CSDs to refer to, or to re-use part of these existing assessments will not only avoid unnecessary duplications, it will also promote consistency. This is particularly relevant for section F of Annex I (prudential requirements). Alternatively, ESMA could consider allowing competent authorities not to request applicant CSDs to provide information on some of the items listed in in Annex 1 of the ESMA Discussion Paper if these competent authorities are confident that the CSD(s) under their jurisdiction comply with the specified items, based on the outcome of recent supervisory assessments.

More generally, CSDs should be allowed to provide hyperlinks (rather than actual paper copies) of publicly available documents in their application file, as is explicitly mentioned under EMIR technical standards.

In the case of CSD links (section G of Annex I in the ESMA Discussion Paper), it should be possible for CSDs and competent authorities to refer to and to rely on existing link assessments, whenever this is applicable. A complete re-assessment of CSD links for the purpose of CSDR authorisation should be avoided, especially given the resources involved in the exercise, notably as part of the ongoing and upcoming Eurosystem link assessments in preparation for CSDs' migration to T2S.
In this context it is also important for ESMA to take into account that CSDs face different timelines in relation to T2S migration.

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.

We agree with the template proposed in Annex II.

Regarding the practical organisation of documentation exchange and reference numbering, we believe that flexibility is needed and that CSDs and their regulators should be able to build on existing processes or reporting mechanisms, whenever these are compatible with the technical standards. For example, we believe it should be up to the competent authority to keep the reference numbering, taking into account the documents that it already possesses. Any provision of new or updated documents to the competent authority would otherwise require a cumbersome and unnecessary update of the list of the documents.

As an additional argument in favour of sufficient flexibility, we note that CSDs that have a banking licence are subject to a different communication and reporting mechanism with their competent authority. Their application for authorisation under CSDR may therefore re-use some of the elements of the banking authorisation.

3. Conditions for CSD participations in other entities - Article 18

WHAT THE LEVEL 1 REGULATION SAYS:
Article 18(4): "An authorised CSD may only have a participation in a legal person whose activities are limited to the provision of services set out in Sections A and B of the Annex, unless such a

participation is approved by its competent authority on the basis that it does not significantly increase the risk profile of the CSD."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 18(5): RTS on "the criteria to be taken into account by the competent authorities to approve participations of CSDs in legal persons other than those providing the services listed in Sections A and B of the Annex. These criteria may include whether the services provided by that legal person are complementary to the services provided by a CSD, and the extent of the CSD's exposure to liabilities arising from that participation."

Q24: Do you see other risks and corresponding mitigating measures? Do CSDs presently have participations in legal persons other than CCPs, TRs and trading venues that should be considered? Would banning CSDs from directly participating in CCPs be advisable, in your view?

We do not agree with all the restrictions suggested by ESMA in relation to CSDs' participations in other entities. We recognise the need for technical standards to ensure that participations in other businesses do not put the CSD activities at risk, but we believe that some of the proposed restrictions are not justified and could actually prevent CSDs from strengthening and diversifying their market infrastructure activities, which in fact are aimed at reducing the overall business risk for the CSD. In a rapidly changing environment, CSDs are increasingly expected to develop innovative solutions to problems faced by market participants. One way of developing such solutions is for a CSD to establish subsidiaries or to have participations in complementary businesses. In smaller markets in particular, the know-how and capital for building new infrastructure institutions is often concentrated in the existing market infrastructures, such as CSDs. Preventing CSDs from holding participations in new business ventures would in such cases hamper market development or it would force small or mid-size CSDs to create multi-layer capital groups, which would increase their functioning costs without any actual benefits.

On the individual proposals more specifically:

1. **On guarantees:**

ESMA suggests prohibiting CSDs from assuming guarantees leading to unlimited liability and allowing limited liability only where the resulting risks are fully capitalised. We agree with ESMA that this requirement is appropriate.

2. **On limiting control:**

The proposed prohibition for CSDs to hold participations where they assume control unless covered by liquid capital is not without problems. First, it is not clear how such a requirement could be implemented in practice. Second, assuming control of an entity in which it holds a participation can be a way for the CSD to better manage the risks resulting from this participation. We **thus recommend that this requirement should be further clarified and should not prevent CSDs from exercising effective control over subsidiaries when competent authorities are confident that the risks resulting from the activities of the subsidiary are properly managed.**

In the UK for example, Euroclear UK and Ireland (EUI) has some nominee companies as subsidiaries which hold international securities for the purpose of EUI's links, and other nominees companies that hold stamp duty monies. None of these entities have a regulated status given their nature. These are used to reduce risks and are essential to provide EUI's services in a safe and efficient way. EUI fully takes responsibility for the position of these entities in its contracts with participants, otherwise participants would have limited recourse against a nominee company with no substance, which would

not be acceptable from a systemic point of view.

Whilst a more flexible approach is needed on the "control" exercised by CSDs over other entities, we believe that CSDs could legitimately be expected to take into account the risks related to their participations in other entities in their recovery plan. In fact, we note that such considerations are already expected of CSDs under global principles[4] and might be further specified in future EU legislation on the recovery of financial infrastructures. **Whereas we support a general requirement for CSDs to include the risks related to their participations in other entities in their recovery plans, we do not think that ESMA should aim to specify further details on the contents and structure of recovery plans, in order not to pre-empt future EU legislation.**

3. **<u>On limiting revenues generated by CSD participations to a certain percentage of total revenues:</u>**

We do not agree with the proposal to limit revenues from participations to 20% of the overall revenues of the CSD.

First, the proposed threshold appears rather arbitrary and does not take into account the nature of the risks involved in the participations.

Second, such a nominal threshold would be cumbersome to implement, especially given the uncertainty about annual revenues. In practice, a CSD might have revenues different from its initial forecast, and find itself in a difficult situation if the revenues from its participations unexpectedly exceed 20% of its total revenues, thereby forcing it to dispose of its participation, possibly at a loss, at a moment where the extra revenues actually contributes to maintaining the financial strength and resilience of the CSD. Managing a fixed cap on revenues would be difficult for CSDs to manage and could expose them to legal uncertainty in relation to participations. It is unclear whether the calculation of revenues over three years would be sufficient to smoothen eventual negative or positive shocks to the CSD's or the external entity's revenues.

Third and perhaps most importantly, such a restriction would in some cases no longer allow CSDs to outsource the performance of some of their ancillary services (as authorised under Section B of the CSD Regulation, for instance) to a separate entity in which they hold a participation, usually with the aim of reducing the risks stemming from the provision of these services to the CSD core activities. In Denmark for example, VP holds participations in a trustee company and a company that provides different ancillary services to the CSD. A general cap on revenues from participations could require CSDs to insource these additional risks back into the CSD and could thus actually increase the risk profile of the CSD, contrary to the objective of CSDR.

We are thus convinced that technical standards should not prescribe a fixed cap on revenues from CSD participations. If the ultimate objective of regulators is to ensure that authorised CSD services remain the core and dominant activity of the CSD, then **technical standards should clearly state this principle, e.g. stating that CSDR-authorised services, including when they are performed by a subsidiary of the CSD, should constitute the main source of revenues of a CSD.** Without imposing a quantitative threshold, such a requirement would force national competent authorities to ensure that CSDs' activities remain focused on their role as financial market infrastructure.

4. **<u>On limiting participations to other entities in the securities chain (trading venue, CCP, trade repository):</u>**

We do not agree with ESMA's proposal, in paragraph 96 of the Discussion Paper, to limit CSD participations to other entities in the securities chain. Indeed, **a CSD can have very legitimate**

[4] Recovery of CSDs is covered by the CPSS-IOSCO Principles for financial market infrastructures of April 2012, and further clarifications are to be provided in a follow-up report to the CPSS-IOSCO Consultative Report of August 2013 on the Recovery of financial market infrastructures.

reasons to hold participations in other types of entities which are not directly part of the securities chain, but still offer complementary services to the CSD's activities, such as IT companies or financial information providers/data vendors. In Norway for instance, VPS holds participations in a network provider and IT company that offers services to management companies for mutual funds. It should also be possible for CSDs to operate a subsidiary offering registrar services (this is for instance the case in Switzerland today, where SIX SIS operates a separate company subsidiary, called SIX SAG Ltd, for share register services). Another good example for such complementary participations that should remain possible are CSD participations in real estate companies which own the offices of the CSD. **We thus recommend removing the requirement "limiting participations to securities chain" from the draft technical standards. Instead, ESMA should require CSDs to hold participations in entities providing "complementary" services to their CSDR-authorised activities.**

In conclusion, we believe that the following restrictions on CSD participations would be faithful to the spirit and the letter of the Level 1 text of the CSD Regulation, thereby ensuring that CSDs maintain a low risk profile:

1) Prohibiting CSDs from assuming guarantees leading to unlimited liability and allowing limited liability only where the resulting risks are fully capitalised;
2) Requiring competent authorities to ensure that the activities of the entities in which a CSD holds participations are complementary to or support the activities of the CSD;
3) Ensuring that CSDR-authorised services, including when they are performed by a subsidiary of the CSD, constitute the main source of revenues of the CSD;
4) Allowing CSDs to assume control over other entities where such control contributes to a better management of the risks to which the CSD is exposed as a result of these participations;
5) Requiring CSDs to take into account the risks related to their participations in other entities in their recovery plan.

4. Review and evaluation - Article 22(10), (11)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 22(1): "The competent authority shall, at least on an annual basis, review the arrangements, strategies, processes and mechanisms implemented by a CSD with respect to compliance with this Regulation and evaluate the risks to which the CSD is, or might be, exposed or which it creates for the smooth functioning of securities markets.

Article 22(7): "The competent authority shall regularly, and at least once a year, inform the relevant authorities referred to in Article 12 and, where applicable, the authority referred to in Article 69 of Directive xxxx/xxxx/EU [new MiFID] of the results, including any remedial actions or penalties, of the review and evaluation referred to in paragraph 1."

Article 22(8): "When performing the review and evaluation referred to in paragraph 1, the competent authorities responsible for supervising CSDs which maintain the types of relations referred to in points (a), (b) and (c) of the first subparagraph of Article 17(6) shall supply one another with all relevant information that is likely to facilitate their tasks."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

Article 22(10): RTS on "(a) the information that the CSD shall provide to the competent authority for the purposes of the review referred to in paragraph 1;

(b) the information that the competent authority shall supply to the relevant authorities referred to in paragraph 7;

(c) the information that the competent authorities referred to in paragraph 8 shall supply one another."

Article 22(11): ITS on "standard forms, templates and procedures for the provision of information referred to in the first subparagraph of paragraph 10."

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.

We generally agree with the proposed approach, and we note that CSDs mostly already provide the information listed in §105 of the Discussion Paper today. That said, we believe that **the notion of "materiality" could be further stressed** to ensure that a CSD's supervisors focus on changes and processes that truly have a potential impact on a CSD's risk profile. We fully support ESMA's statement in §100 of the Discussion Paper that *"authorities should, in a post-crisis context, increase their capabilities of ongoing supervision rather than over-relying on ad-hoc supervision"*. And we note that CSDs will be required under CSDR article 16(3) to *"inform competent authorities without undue delay of any material changes affecting the conditions for authorisation".* Technical standards should thus acknowledge that there is already an efficient ongoing supervisory regime in place, and that additional ad-hoc reviews should focus on material changes affecting the CSD's risk profile, without duplicating with the information provided in the context of the ongoing supervisory assessments. Focusing on relevant updates only would considerably facilitate the work for competent authorities and thus contribute to the efficiency of the supervision process. We support ESMA's intention expressed in § 104 to focus on the quality of the documentation rather than on the quantity and that *"only relevant documents should be provided".* This principle should be clearly reflected in the draft technical standards.

For example, we share the opinion that the minutes of meetings of the management body of the CSD might sometimes provide relevant information in the course of a supervisory review, but this will not generally be the case. Thus we believe that an obligation for CSDs to provide copies of the minutes of meetings of their management body to competent authorities should be sufficient, and that it is not necessary to require all meetings minutes to be provided by CSDs as part of the annual review process.

As for the annual review of CSD's compliance with the regulation, it should rely as much as possible on information already provided by the CSD and only require CSDs to provide information where such information is not yet available to the competent authorities. CSDs should for instance not be required to prepare extensive additional reports summarising information that was already sent to the competent authorities.

We expect that the annual review according to article 22 of CSDR will replace the previous reviews carried out using the ESCB-CESR framework. Given that the CSDR requirements go beyond the former ESCB-CESR standards (they also go beyond the CPSS-IOSCO Principles for financial market infrastructures), We consider that the former, non-binding, ESCB-CESR standards should be discontinued once they have been replaced by binding technical standards assessing CSD's compliance with the CSDR requirements.

The annual review exercise should also leverage as much as possible on CSDs' assessments against CPSS-IOSCO PFMIs, which cover most of the information required for the review.

5. Recognition of third country CSDs - Article 25

WHAT THE LEVEL 1 REGULATION SAYS:

Article 25(6): "6. The third country CSD referred to in paragraph 1 shall submit its application for recognition to ESMA.

The applicant CSD shall provide ESMA with all information deemed necessary for its recognition. Within 30 working days from the receipt of the application, ESMA shall assess whether the application is complete. If the application is not complete, ESMA shall set a time limit by which the applicant CSD has to provide additional information.
The competent authorities of the Member States in which the third country CSD intends to provide CSD services shall assess the compliance of the third country CSD with the laws referred to in point (d) of paragraph 4 and inform ESMA with a fully reasoned decision whether the compliance is met or not within three months from the receipt of all the necessary information from ESMA.
The recognition decision shall be based on the criteria set out in paragraph 4.
Within six months from the submission of a complete application, ESMA shall inform the applicant CSD in writing with a fully reasoned decision whether the recognition has been granted or refused."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 25(12): RTS on "the information that the applicant CSD shall provide ESMA in its application for recognition under paragraph 6".

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

We agree with ESMA that *"the definition of the items that a non-EU CSD could provide for EU recognition purposes could be similar to the elements required for the registration of an EU CSD"* and we expect ESMA to further define the necessary adaptations, if any, in technical standards. Indeed, as is the case in EMIR technical standards, we believe that the CSDR technical standards should include a list of all requirements for third country CSDs to apply for recognition.

Unlike in the case of EMIR however, the scope of the third country provisions in the Level 1 text of the CSD Regulation is not entirely clear and could require further clarifications in Level 2 standards. One important difference with EMIR is for instance that CSDR does not provide recognised third country CSDs with an EU 'passport' but rather seems to follow a market-by-market approach.

Furthermore, **the current recognition procedure seems to be designed as a one-off exercise, whereas it should be an ongoing process.** Once a third country CSD is recognised, there should be follow-up arrangements and requirements in place to ensure ongoing supervisory equivalence. We thus encourage ESMA to adopt a 'dynamic approach' in the technical standards on third country CSDs in order to ensure continued equivalence.

Finally, we believe that ESMA should consider reciprocity in market access. It is well known that many non-EU countries do not share the EU's policy of increasing competition between CSDs and favour instead monopoly provision of CSD services. This difference should be reflected in the recognition and supervision process for third country CSDs to ensure that CSDs can only compete in the EU if the respective EU CSDs can also enter that third country's CSD market.

6. Monitoring tools for the risks of CSDs, responsibilities of key personnel, potential conflicts of interest and audit methods - Article 26

WHAT THE LEVEL 1 REGULATION SAYS:
Article 26(1): "A CSD shall have robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which it is or might be exposed, and adequate remuneration policies and internal control mechanisms, including sound administrative and accounting procedures."

Article 26(3): “A CSD shall maintain and operate effective written organisational and administrative arrangements to identify and manage any potential conflicts of interest between itself, including its managers, employees, members of the management body or any person directly or indirectly linked to them, and its participants or their clients. It shall maintain and implement adequate resolution procedures whenever possible conflicts of interest occur.”
Article (6): “A CSD shall be subject to regular and independent audits. The results of these audits shall be communicated to the management body and made available to the competent authority and, where appropriate taking into account potential conflicts of interest between the members of the user committee and the CSD, to the user committee.”

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 26(8): RTS on:
(a) “the monitoring tools for the risks of the CSDs referred to in paragraph 1, and the responsibilities of the key personnel in respect of those risks”
(b) “the potential conflicts of interest referred to in paragraph 3”
(c) “the audit methods referred to in paragraph 6 at the CSD level as well as at the group level and the circumstances in which it would be appropriate, taking into account potential conflicts of interest between the members of the user committee and the CSD, to share audit findings with the user committee in accordance with paragraph 6.”

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?

(a) Monitoring tools and responsibilities of key personnel:

- **Monitoring tools**

We do not agree with the proposal made by ESMA in §110 of its Discussion Paper which would require CSDs to monitor not only their own risks, but also to the risks they pose to participants and other entities. This is not consistent with and goes beyond Article 26(1) in the Level 1 text of the CSD Regulation, which requires CSDs to *“identify, manage, monitor and report the risks to which it is or might be exposed”.*
Besides, it is not clear how a CSD would be able to identify, manage, monitor and report risks in relation to participants’ clients. In our view, it is the responsibility of the respective participant to assess and manage the risks in relation to its clients.
Therefore we recommend that **technical standards on monitoring tools should be limited to the risks faced by CSDs.**

- **Responsibilities of key personnel**

We agree with the lists of responsibilities of key personnel suggested by ESMA.

However, we would like ESMA to bring some clarifications to the **notion of “dedicated functions”**. Indeed, the requirement to have several dedicated functions (chief risk officer, compliance officer, chief technology officer and independent internal audit) should be interpreted flexibly taking into account the principle of proportionality, given that **such functions will not always justify a full-time job in smaller organisations**. In many CSDs today, the Legal Counsel of the CSD acts as Compliance Officer, for instance. This should continue to be allowed in the future. Similarly, in corporate groups, a single employee often fulfils one of the “dedicated functions” for the entire group, or for different

entities within the group. This should continue to be allowed in the future, especially because:

- It allows for a more efficient allocation of tasks and, in the case of corporate groups for instance, provides some benefits (e.g. group-wide perspective on risks);
- Among the 31 CSDs established in the EEA that are members of ECSDA, 21 have less than 100 employees, and among these 12 have less than 50 employees. For such CSDs, it could prove impossible to attract a sufficiently qualified employee for performing the "dedicated functions" if the function is not combined with other functions.

As a result**, technical standards should make it clear that the "dedicated functions" should be clearly attributed to an individual, but that this individual should be allowed to perform other functions, as long as any potential conflicts of interests are disclosed and managed**, according to the relevant provisions of CSDR.

(b) Potential conflicts of interest:

We generally agree with ESMA's approach on conflicts of interest but we think that some clarifications are required as regards the examples listed in §116 of the Discussion Paper. The list provided is indeed quite extensive and could give rise to somewhat excessive interpretations. For example, the mere fact of holding shares in a publicly listed company that is also a client or a partner firm of the CSD does not necessarily entail a conflict of interest. CSDs typically work with many large listed companies, and prohibiting every CSD employee to hold shares in such companies would clearly be excessive. **The focus should be on 'material' holdings in companies having a business relationship with the CSD, which might in some cases give rise to a conflict of interests.** Targeting the 'real' conflicts of interest is all the more important since CSDs will be legally required to *"maintain and operate effective written organisational and administrative arrangements to identify and manage any potential conflicts of interest".*

We also expect that not all 'conflicts of interests' identified by the CSD will need to be 'managed' (e.g. requiring special adaptations or procedures), and that in many cases disclosure of such potential conflicts of interest will suffice.

(c) Audit methods:

We generally agree with §119 of the Discussion Paper which stresses the importance of an independent internal audit function. We insist, however, that the notion of an 'independent and separate" internal audit function should be applied proportionately, taking into account that **it should be allowed for smaller CSDs to combine the internal audit function with other functions, as long as a sufficient degree of independence is guaranteed** (see also our comments on "dedicated functions" under point b) above).

We recommend that independent audits should be planned and performed on a risk-based approach following a cyclical approach so that all processes are audited at least every 3 to 5 years.
As for the use of external auditors to assess and 'audit' the internal audit function on a yearly basis (§120 and 121 of the Discussion Paper), we would like to express three concerns:

- First, the meaning of Article 26(6) in the Level 1 text of CSDR is not entirely clear. The article only states that CSDs shall be *"subject to regular and independent audits".* Given that the results of such audits might have to be communicated, in certain cases, to the user committee of the CSD, we assumed that the Level 1 text was referring to an audit of CSD's financial statements by an external auditor.
- Second, if the intention of the legislator is indeed to require by law that a 'risk audit' be performed by an external auditor, in addition to the annual audit of the accounts, a proportionate approach needs to be adopted, given the important differences among CSDs as regards the size and complexity of their business. Such external audits will represent an additional cost for CSDs, and will come on top of existing supervisory assessments, financial

audits and internal audit assessments.

- Third, we note that Question 27 of the Discussion Paper seems to invert the logic of the CSDR Level 1 text by asking for cases where the sharing of audit results with the user committee would not be appropriate. The question seems to assume that, by default, CSDs should share these results with the user committee, whereas the Level 1 text mandates ESMA to specify the *"circumstances in which it would be appropriate (...) to share audit findings with the user committee".* 'Risk' audits, unlike financial audits, often contain sensitive non-public information on detailed risk management processes, procedures and circumstances which are not meant to be disclosed outside the CSD and its regulator(s). For example, it is conceivable that such audits could contain information on the risks posed by (a) specific client(s) of the CSD, or on very specific services, and such information should clearly remain confidential. This is especially true given the competitive environment in which CSDs operate and the fact that CSD participants are also often competitors to the CSD for the provision of certain services.

As a result, subject to the confirmation by the EU legislator that the Level 1 text truly intends to require an external audit of a CSD's internal risk management processes – and not only of the CSD's financial statements, We recommend the adoption of a proportionate approach to cater for the situation of smaller CSDs, as well as a description, in the technical standards, of the limited number of cases where the audit results could be provided to the user committee, taking into account potential conflicts of interest and confidentiality requirements.

Finally, when specifying CSDR audit requirements, ESMA should take into account that CSDs operating with a banking licence are already subject to extensive audit requirements under CRD IV. Duplications and inconsistencies between both sets of requirements should be avoided.

7. Recordkeeping - Article 29(3), (4)

WHAT THE LEVEL 1 REGULATION SAYS:
Article 29(1): "A CSD shall maintain, for a period of at least ten years, all the records on the services and activity provided, including on the ancillary services referred to in Sections B and C of the Annex, so as to enable the competent authority to monitor the compliance with the requirements under this Regulation."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 29(3): RTS on "the details of the records referred to in paragraph 1 to be retained for the purpose of monitoring the compliance of CSDs with the provisions of this Regulation."
Article 29(4): ITS on "the format of the records referred to in paragraph 1 to be retained for the purpose of monitoring the compliance of CSDs with the provisions of this Regulation."

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?

- **"Minimum requirements" approach**

We do not agree with the "minimum requirements" approach proposed by ESMA for CSD recordkeeping and believes a different approach that ensures truly harmonised standards and a level playing field for CSDs would be more appropriate.

it A minimum requirements approach could result in some national regulators 'gold-plating' the ESMA list and adding additional requirements, thereby introducing distortions among CSDs. Instead, we suggest that ESMA should follow whenever possible a "maximum requirements" approach, providing a

harmonised list of records while giving some flexibility to competent authorities not to require records that are not relevant for the particular CSD.

That said, we recognise that there will be cases where a need is identified for regulators to have access to certain information that is not part of regular recordkeeping. In such cases, competent authorities should retain the possibility to request CSDs to keep and provide such information, but such requests will typically have a different justification and other purposes than assessing CSDR compliance.

- **Contents of the recordkeeping requirements**

The list of items in Annex III of the Discussion Paper is very extensive and goes far beyond what is required by regulators today. In fact, based on our understanding of ESMA's current proposal, the quantity of data to be stored over (a minimum of) 10 years and related functionalities would result in **potentially huge IT costs**, as it would require many CSDs to build an entirely new IT system, or at least to substantially overhaul their existing systems. Indeed some of the proposed technical requirements, such as an online inquiry possibility, the possibility to re-establish operational processing, a query function through numerous search keys, and direct data feeds, are much more demanding than current CSD recordkeeping practices. Adapting to these requirements would require a combined investment of tens of millions of euros for ECSDA members.

Moreover, for CSDs participating in T2S in particular, having to develop a parallel system outside T2S will create a lot of complexity while negatively impacting the cost efficiencies generated by the use of a single, centralised platform for all T2S markets. We thus believe that the requirements being proposed by ESMA are disproportionate, and go beyond what is necessary to ensure effective supervision.

Most importantly, we believe that the purpose of recordkeeping requirements, as specified in CSDR Article 29, is to allow supervisory authorities to ensure *"compliance [of the CSD] with the requirements under this Regulation."* The objective is not and should not be to:

- Use CSDs as trade repositories, to retrieve market data at individual transaction/instruction level, and obtain details on activities of individual CSD clients;
- Use these records as a way to 'recover' CSD activities in case of financial or operational failures.

Recordkeeping should thus be understood in the light of supervisors' assessment of CSDs' compliance with CSDR, and should be distinct from considerations on trade repository services or recovery and resolution plans. For CSDs, recordkeeping is essentially about data retention and archiving in order to be able to reply to inquiries by competent authorities.

In particular, we are not aware of any specific problems or complaints by regulators as regards the current level of detail of the records stored by CSDs. The rationale behind the far-reaching requirements being proposed by ESMA is thus difficult to understand, and we see very limited added value in keeping an unnecessarily heavy amount of data, especially given the **burden it will impose on regulators themselves**, when making use of the data.

As a result, we believe that the list of records contained in Annex III of the Discussion Paper should be significantly shortened. Many of the items in the proposed list generally do not seem relevant for the purpose of ensuring compliance with CSDR. At a minimum, the following items should be removed from the list:

SR3	Persons exercising control on Issuers
SR13	Persons exercising control on Participants
SR14	Country of establishment of persons exercising control on Participants

FR3	Client of the delivering participant, where applicable
FR9	Client of the receiving participant, where applicable

CSDs typically do not have access to such information and it is unclear how such records would contribute to evidence CSD's compliance with CSDR requirements.

CSDR technical standards should take into account the fact that some of the listed records are linked to the provision of specific services which not all CSDs might offer. CSDs that do not provide certain services should naturally not be expected to keep the corresponding records. In this context, we welcome the more flexible approach adopted by ESMA on records in relation to ancillary services (§126). However, we would like to recall that the definition of a CSD in Article 2 of CSDR does not require CSDs to provide all three core services, but only two out of the three. Hence, recordkeeping requirements will need to take this into consideration. Actual data available to the CSD will depend on its service offering and the data required for its operational processes. The recordkeeping requirements will thus have to be adapted depending on the individual services provided by a given CSD based on the list of services contained in sections A, B and C of the Annex of the CSD Regulation.

Regarding point iii) under §128 of the Discussion paper stating that *"it is not possible for the records to be manipulated or altered"*, we suggest that ESMA should clarify that the prohibition to alter records applies to transaction data. For other records and static data, it should be possible for the CSD to make changes, albeit with a strict track record of the amendments made.

Estimated costs for implementing the current ESMA proposals on recordkeeping:

Based on data collected from 18 EU CSDs (out of a total of 33), ECSDA has attempted to estimate the direct costs of implementing the requirements suggested by ESMA in its Discussion Paper. These estimates do not take into account the potential costs for regulators (e.g. in handling the required records) and for market participants (e.g. in case the use of LEI would be required). We distinguish between (a) one-off development costs, primarily to build the system required to be able to fulfil ESMA requirements (including the use of a non-proprietary format, LEIs and a direct data feed access for regulators); (b) and annual running costs, to maintain the system.

A. One-off costs

The total estimated system development costs for all 18 CSDs in the sample are considerable, ranging between EUR 41.3 million and EUR 62.4 million (depending on the final specifications of the requirements and other factors)**.**
In terms of average costs per CSD, this would mean EUR 2.3 million to EUR 3.5 million.

Understandably, individual costs differ substantially across CSDs, partly due to differences in current system specifications. However, for most CSDs, the highest development costs would result from the mandatory use of a non-proprietary format and of LEIs. For example, based on the cost figures provided, we estimate that it could cost over EUR 500,000 for a small to mid-size CSD to upgrade its system to allow for the use of LEIs. For a larger CSD, the cost would most certainly exceed EUR 1 million. The cost of developing a direct data feed for regulators would generally be lower but could still reach over EUR 500,000 for some CSDs.

Overall, ECSDA estimates that development costs could be considerably reduced if CSDs would be allowed to store the required records in proprietary format (while providing for this format to be 'converted' to an international format upon request) and if LEIs would not be required.

B. Running costs

The total estimated annual running costs for all 18 respondent CSDs are between EUR 11.1 million and EUR 13.7 million.

On average, this translate into annual "running costs" per CSD from EUR 600,000 to EUR 800,000.

C. Overall costs

Given that the aggregated figures above are based on a broadly representative sample of CSDs, we can derive from the average figures the following total estimated costs for the **entire CSD sector in the EEA** (33 EEA CSDs) :
Total estimated system development costs for all 33 EEA CSDs: EUR 75.7 Mio – EUR 114.3 Mio
Total estimated annual running costs for all 33 EEA CSDs: EUR 20.3 Mio – EUR 25.0 Mio

D. Timing and human resources

It is also worth noting that, besides the pure monetary costs of building and maintaining a system to support the proposed ESMA requirements on recordkeeping, CSDs would require a considerable time to implement these requirements, and would face a considerable challenge in mobilising the required human resources.

Should ESMA maintain all the requirements proposed in its Discussion Paper, ECSDA estimates that **CSDs would need on average slightly more than 14 months in order to fully comply with the recordkeeping rules.**

- **Format of the records**

As regards the format of the records to be stored, we think it is not necessary (and indeed sometimes not possible) to require CSDs to maintain records online (immediately available) but that **it should be sufficient to store the data offline as long as this data can be retrieved within a few days.** This is a much more practical approach, considering the high amount of data involved.

We also caution against imposing the use of open, non-proprietary standards for recordkeeping purposes. Such a requirement would entail huge costs and would require significant changes to CSDs' system. Instead, **ESMA should allow CSDs to maintain records in a proprietary format wherever this format can be converted without undue delay into an open format that is accessible to regulators.**

- **Timing of implementation**

Depending on the final recordkeeping requirements to be included in the CSDR technical standards, CSDs might have to make considerable investments to build and maintain the relevant IT systems, and such developments are likely to take months to implement. This could mean that **it will be close to impossible for most CSDs to comply with the recordkeeping requirements by the time they apply for authorisation under CSDR.** ESMA should consider such a constraint and determine an appropriate transition period to allow CSDs to develop the required functionalities.

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?

- **Direct data feeds for regulators**

We do not believe that technical standards should require CSDs to build and maintain direct data feeds for their competent authorities, and we wonder whether such a measure might not exceed the mandate granted to ESMA under the Level 1 Regulation. In addition to the cost considerations, it is questionable whether regulators will truly make use of such data feeds, and it is far from certain that such type of data exchange would present significant advantages compared to a situation where

CSDs provide data promptly to regulators upon request. The use of direct data feeds is currently limited to a few countries and experience suggests that regulators tend to continue to rely on ad hoc requests for information to the CSD, even when they can access the data directly, because the latter is often more convenient.

- **Use of LEI**

We do not believe that CSDs should be required to use global Legal Entity Identifiers (LEI) in their records. Such identifiers are not currently in use at CSD level, and their implementation has been limited so far to OTC derivatives markets, where CSDs are typically not involved. Imposing the use of LEIs for the purpose of recordkeeping is unlikely to bring any substantial benefits. As mentioned earlier, CSD recordkeeping requirements should not result in regulators transforming CSDs into trade repositories. Imposing the compulsory use of LEI would require costly changes to current CSD systems and would also increase costs for CSD participants (who would subsequently be required to adapt their systems as well). Such a requirement would also exceed the Level 1 mandate under Article 29 of CSDR.

Moreover, there are specific challenges for direct holding markets that need to be carefully considered. If the requirement to use LEIs were to include all account holders at these CSD, this could encompass several hundred thousand companies. Beyond imposing significant administrative costs on these companies, such a requirement would go against the principle, stated in the CSD Regulation, of neutrality in relation to different account holding models in Europe. The same general reasoning would apply if the requirement were to include issuers, most of which do not use LEI today.

Without denying the benefits linked to the use of LEIs in terms of harmonisation, we believe that CSDR technical standards on recordkeeping are clearly not the right place to promote their wider use. More analysis is needed, and a gradual implementation of LEIs outside derivatives markets should be coordinated at global level, rather than being imposed on EU CSDs only via binding regulation.

8. Refusal of access to participants - Article 33(5), (6)

WHAT THE LEVEL 1 REGULATION SAYS:
Article 33(3): “A CSD may only deny access to a participant meeting the criteria referred to in paragraph 1 where it is duly justified in writing and based on a comprehensive risk analysis.
In case of refusal, the requesting participant has the right to complain to the competent authority of the CSD that has refused access.
The responsible competent authority shall duly examine the complaint by assessing the reasons for refusal and shall provide the requesting participant with a reasoned reply.
The responsible competent authority shall consult the competent authority of the place of establishment of the requesting participant on its assessment of the complaint. Where the authority of the requesting participant disagrees with the assessment provided, any one of the two competent authorities may refer the matter to ESMA, which may act in accordance with the powers conferred on it under Article 19 of Regulation (EU) No 1095/2010.
Where the refusal by the CSD to grant access to the requesting participant is deemed unjustified, the responsible competent authority shall issue an order requiring that CSD to grant access to the requesting participant.”

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 33(5): RTS on “the risks to be taken into account by CSDs when carrying out a comprehensive risk assessment, and competent authorities assessing the reasons for refusal in accordance with paragraph 3 and the elements of the procedure referred to in paragraph 3.”

Article 33(6): ITS on "forms and templates for the procedure referred to in paragraph 3."

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.

We broadly agree with ESMA's proposal as regards the type of risks that need to be taken into consideration in the risk analysis when justifying the refusal of an applicant participant by a CSD. A distinction of legal, financial and operational risks is reasonable. The examples provided by ESMA for each category are helpful indications, but they should not be considered as an exhaustive list.

As regards legal risks and the third example listed by ESMA under §137(a) of the Discussion Paper, it is important to clarify that CSDs cannot be expected to assess whether *"the requesting party is not compliant with prudential requirements"*, and that they **should be allowed to rely on the existing authorisations obtained by the requesting party.** For example, an institution authorised to operate as a credit institution is deemed to comply with the prudential requirements applicable to banks in its jurisdiction, and the CSD, not being a banking supervisor, is not in a position to make a judgement on the compliance of that credit institution with applicable rules.

Furthermore, it is important to keep in mind that the 'risk analysis' mentioned in Article 33(3) of CSDR is only required in cases of refusal. In principle, this means that CSDR technical standards should not impact the procedure followed by CSDs when approving a new participant. In other words, the criteria for refusal provided by ESMA, which are 'negative' criteria (on what is not acceptable for obtaining the status of CSD participant) should not be interpreted as a substitute for the regular approval process for CSD participants based on 'positive' participation criteria specified by each CSD. Considering the criteria to be specified in CSDR technical standards under Article 33(5) as a basis for the initial assessment of applicant-participants would be misguided, and would result in a more complex and lengthy approval process for CSD participants. Instead, it should be clear that the technical standards are limited to exceptional cases where the CSD has doubts on the eligibility of an applicant-participant.

We would also like ESMA to ensure that the future CSDR technical standards do not prevent corporates (i.e. non-financial institutions) to be accepted as CSD participants, when applicable (for example corporates making use of CSD services in the repo market).

Finally, we note that in some cases specific participation criteria are determined by national law. In France, for instance, only custodian banks authorised as "*teneurs de comptes-conservateurs*" are legally eligible as participants in the CSD. In other countries, the CSD regulator has to confirm its approval of new CSD participants. As a result, it will be important to avoid contradictions between CSDR technical standards and national rules on CSD participation. We assume that the current national rules will need to be adapted in line with the new technical standards.

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.

Yes, we agree with the proposed time frames.

9. Integrity of the issue - Article 37

WHAT THE LEVEL 1 REGULATION SAYS:

Article 37(1): "A CSD shall take appropriate reconciliation measures to verify that the number of securities making up a securities issue or part of a securities issue submitted to the CSD is equal to

the sum of securities recorded on the securities accounts of the participants of the securities settlement system operated by the CSD and, where relevant, on owner accounts maintained by the CSD. Such reconciliation measures shall be conducted at least daily."
Article 37(2): "Where appropriate and if other entities are involved in the reconciliation process for a certain securities issue, such as the issuer, registrars, issuance agents, transfer agents, common depositories, other CSDs or other entities, the CSD and any such entities shall organise adequate cooperation and information exchange measures with each other so that the integrity of the issue is maintained."
Article 37(3): "Securities overdrafts, debit balances or securities creation shall not be allowed in a securities settlement system operated by a CSD."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 37(4): RTS on "reconciliation measures a CSD shall take under paragraphs 1 to 3."

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.

We are not convinced that 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, should be included in CSDR technical standards. We understand that ESMA's proposal would be aligned with T2S requirements, but we are not convinced that similar requirements should be imposed outside the scope of T2S.

Given the complexity and technicality of the issue, we believe that further discussions are necessary on this issue, with ESMA but also with the ECB, to find a suitable balance and avoid inconsistencies between the CSDR, T2S and the Eurosystem assessment framework ("User addendum" of January 2014[5]).

As regards §144 of the Discussion Paper, we do not fully understand the case raised by ESMA. Preventing settlements in case of a reconciliation issue is a measure that entails important risks for market participants and the CSD.

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, we do not see the need for special reconciliation measures in case of corporate actions. In fact, standard reconciliation procedures of CSDs already cover corporate actions, and we are not sure why a specific treatment for corporate actions is being considered by ESMA.

We would also like to point out that, in the case of dividend payments, for example, the issuer or its agent, rather than the CSD, is legally responsible for the reconciliation of individual payments with individual shareholders.

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

[5] See http://www.ecb.europa.eu/pub/pdf/other/frameworkfortheassessmentofsecuritiessettlementsystems201401en.pdf

securities overdrafts, debit balances and securities creation, or should the standard also specify other measures?

Yes, we agree that double-entry accounting gives CSDs a sufficiently robust basis to avoid securities overdrafts, debit balances and securities creation.

We do not think that CSDR technical standards should specify other measures.

10. Operational risks - Article 45

WHAT THE LEVEL 1 REGULATION SAYS:
Article 45(1): "A CSD shall identify sources of operational risk, both internal and external, and minimise their impact through the deployment of appropriate IT tools, controls and procedures, including for all the securities settlement systems it operates."
Article 45(3): "For services it provides as well as for each securities settlement system it operates, a CSD shall establish, implement and maintain an adequate business continuity policy and disaster recovery plan to ensure the preservation of its services, the timely recovery of operations and the fulfilment of the CSD's obligations in the case of events that pose a significant risk of disrupting operations."
Article 45(4): "The plan referred to in paragraph 3 shall provide for the recovery of all transactions and participants' positions at the time of disruption to allow the participants of a CSD to continue to operate with certainty and to complete settlement on the scheduled date, including by ensuring that critical IT systems can promptly resume operations from the time of disruption. It shall include the setting up of a second processing site with sufficient resources, capabilities, functionalities and appropriate staffing arrangements."
Article 45(6): "A CSD shall identify, monitor and manage the risks that key participants to the securities settlement systems it operates, as well as service and utility providers, and other CSDs or other market infrastructures might pose to its operations. It shall, upon request, provide competent and relevant authorities with information on any such risk identified.
It shall also inform the competent and relevant authorities without delay of any operational incidents resulting from such risks."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 45(7): RTS on "the operational risks referred to in paragraphs 1 and 6, the methods to test, address or minimise those risks, including the business continuity policies and disaster recovery plans referred to in paragraphs 3 and 4 and the methods of assessment thereof."

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

We agree with the definition proposed by ESMA and consider it sufficient. We fully support referring to the definition of operational risk included in the CPSS-IOSCO Principle for financial market infrastructures as we believe this will guarantee consistency with global standards.

Q36: The above proposed risk management framework for operational risk considers the existing CSDs tools and the latest regulatory views. What additional requirements or details do you propose a risk management system for operational risk to include and why? As always do include cost considerations.

We do not think that additional requirements or details are necessary, given the already detailed provisions included in the CPSS-IOSCO Principle for financial market infrastructures and their

assessment methodology[6]. We welcome ESMA's approach, which is based on these Principles, but we think clarifications are required on the following issues:

Paragraph in the ESMA Discussion Paper	Clarifications required
§154: CSDs should have a *"robust operational risk-management framework with appropriate IT systems, policies, procedures and controls".*	This principle should not be understood as a requirement for CSDs to use special IT tools for operational risk management. There exist some third party IT solutions for managing operational risk but they are not commonly used by CSDs and are not necessarily more appropriate than, or superior to, the established tools and systems for managing operational risk management within CSDs. This is especially true for CSDs not exposed to credit risk.
§157: *"The CSD should have a central function for managing operational risk".*	We agree with ESMA's statement but wish to stress that a 'central function' should be understood as a requirement that responsibilities for the management of operational risks are clearly attributed, not as a requirement for the function to be performed by a CSD employee on an exclusive basis, especially in smaller CSDs (see our answer to question 27 on the responsibilities of key personnel).
§160: The CSD *"should also have comprehensive and well-documented procedures in place to […] resolve all operational incidents"*	We suggest rephrasing the end of the sentence as follows: *"all* ***material*** *operational incidents"* in order to ensure a reasonable and proportional interpretation. The mentioned procedures should not be required for insignificant incidents that do not affect in any way the efficient functioning of a CSD system.
§161: *"The operational risk management processes […] should be subject to regular reviews performed by internal or external auditors".*	ECSDA considers that the review of operational risk management processes will typically be undertaken by the internal auditor, rather than an external auditor (see also our response to question 27 on audit methods).

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, we believe that the ESMA proposal is sufficient.

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

We do not agree with the ESMA proposal, in §167 of the Discussion Paper, to make mandatory an annual yearly review of the IT system(s) and IT security framework of all CSDs. Indeed we believe that the proposed (annual) frequency is excessive, and we think that such reviews should be applied with the 'proportionality' principle in mind, especially given the high amount of resources involved in such annual reviews. A frequency of 3 to 5 years for such reviews appears more appropriate.

Q39: What elements should be taken into account when considering the adequacy of

[6] Other sources for standards on the management of operational risk include the Eurosystem Business continuity oversight expectations for systemically important payment systems and the High-level principles for business continuity, of the Joint Forum of the Basel Committee on Banking Supervision, among others.

resources, capabilities, functionalities and staffing arrangements of the secondary processing site and a geographic risk profile distinct from that of the primary site?

Requirements imposed on CSDs for a secondary processing site illustrate the importance of a proportional and targeted approach. The meaning of a *"geographically distinct risk profile"* will necessarily depend on local conditions and cannot be defined in an overly prescriptive way, for instance specifying an exact minimum distance. The focus should be on risks, in particular the likelihood of natural disasters. The geographical distance between the first and second processing sites of CSDs today differs considerably. Such decision involves, in particular for smaller CSDs, a trade-off between risk considerations and the quality of the services that can be provided in the secondary site (which partly depends on the possibility to quickly transfer part of the employees from one site to the other). Because such considerations require knowledge of the local geographic and market conditions, we believe that technical standards should leave some room for local regulators to apply the requirements appropriately.

In line with the single market objective of CSDR, **we recommend that technical standards foresee the possibility for a CSD to (i) have its primary production technology *(servers, software platform, hosting, data-processing and related support services)* located and (ii) secondary processing site set up in different Member State** (than its home member state). While such a solution will only be appropriate in a limited number of cases, it could have merit for CSDs belonging to multinational corporate groups, especially as integration of European financial markets deepens in the future. We also believe that technical standards should not prevent a CSD from outsourcing the hosting and operation of a primary production technology and secondary site to another legal entity, provided solid and adequate contractual arrangements risk control measures are in place.

Furthermore, ESMA should be aware that CSDR technical standards on operational risk are likely to require some CSDs to amend their policy on the use of their secondary processing site. **In case one or more EU CSDs find themselves in a situation where they have to set up a new secondary processing site in order to comply with CSDR technical standards, it is important that this CSD is given a sufficient time to implement the required changes, i.e. at least 6 months after the entry into force of the technical standards.** This is unavoidable given the important financial and operational resources involved in such projects.

Finally, on §168, we would like to note that T2S currently foresees a maximum recovery time of **4 hours** for critical CSD functions, and not 2 hours as suggested by ESMA in the third bullet point.

Q40: In your opinion, will these requirements for CSDs be a good basis for identifying, monitoring and managing the risks that key participants, utility providers and other FMIs pose to the operations of the CSDs? Would you consider other requirements? Which and why?

Yes, we agree that the requirements proposed by ESMA form 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.

11. Investment policy - Article 46

WHAT THE LEVEL 1 REGULATION SAYS:

Article 46(1): "A CSD shall hold its financial assets at central banks, authorised credit institutions or authorised CSDs."

Article 46(2): "A CSD shall have prompt access to its assets, when required."

Article 46(4): "The amount of capital, including retained earnings and reserves of a CSD which are not

invested in accordance with paragraph 3 shall not be taken into account for the purposes of Article 44(1)"

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 46(6): RTS on
(a) "the financial instruments that can be considered as highly liquid with minimal market and credit risk as referred to in paragraph 1"
(b) "the appropriate timeframe for access to assets referred to in paragraph 2"
(c) "the concentration limits as referred to in paragraph 5".
"Such draft regulatory technical standards shall where appropriate be aligned to the regulatory technical standards adopted in accordance with Art. 47(8) of Regulation No 648/2012 (EMIR)."

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?

We agree with the proposed approach. We would like to stress, however, that unlike CCPs, CSDs do not use their capital to guarantee clearing, and that restrictions on their investment policy thus do not necessarily need to be as strict as the EMIR requirements. In practice, CSDs typically have a limited amount of capital to invest and generally keep that capital in cash deposits.

We agree with ESMA that a distinction between CSD providing banking services and other services can be relevant for the purpose of determining rules on investment policy. For CSDs with a banking licence, the investment of their capital will generally be a function of the management of their liquidity risk and will therefore fall under the scope of CSDR Article 59. It will thus be important that the technical standards proposed by ESMA under CSDR Article 46 do not override those that will be developed by EBA on CSDR Article 59.

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

No. Given the relatively low level of capital of CSDs, resulting from their low risk profile, additional rules do not seem proportionate. For CSDs having a banking licence and a more extensive capital base, the rules in CSDR article 59 should prevail.

On the proposals made by ESMA in relation to the definitions, we would like to stress, as noted previously, that many EMIR requirements are not appropriate for CSDs.

For example, we understand that EMIR requires CCPs to develop their own methodology for credit ratings instead of relying on ratings from external credit agencies for the purpose of determining whether a credit institution has a low credit risk, and is thus eligible to hold CCP assets. We would like ESMA to clarify that CSDs should be allowed, as an alternative to internal evaluations, to use credit ratings from external agencies for the purpose of managing their investment risk, given that unlike CCPs they are usually not involved in managing credit risks.

Likewise, concentration limits often do not seem appropriate for CSDs with only very limited capital, especially since such capital is typically mostly invested in cash. One solution, for example, could be for ESMA to specify a *de minimis* threshold in relation to the CSD's capital level below which concentration limits are not necessary.

Besides, we do not fully agree with ESMA's statement, in §182 of the Discussion Paper, that *"CSDs should not be allowed, as principle, to consider their investment in derivatives to hedge their interest*

rate, currency or other exposures."

In some cases it should be possible for CSDs to hedge against interest rate or currency risk, for example. This is certainly needed for CSDs with a banking licence. We do not consider the use of the instruments for hedging as "investments".

Finally, we would like to suggest an amendment to §181 of the Discussion Paper. We do not think that point (ii) which states that CSDs should not invest in debt instruments with *"an average duration greater than two years until maturity",* is appropriate. Indeed, the average duration until maturity of debt instruments has in many cases no influence on the liquidity of the instrument. In fact, the liquidity of debt instruments with an average duration of more than 2 years until maturity is not generally lower than for shorter-dated instruments. **We thus recommend removing point (ii) from the list of criteria.**

Regarding eligible debt instruments, we note that existing EMIR technical standards do not specify the concrete category of highly liquid debt instruments, but lists a set of conditions to be considered (Annex II of EC delegated regulation 153/2013). In particular, debt instruments can be considered highly liquid and with minimum market and credit risk where *"the CCP can demonstrate that they have low credit and market risk based upon an internal assessment by the CCP. In performing such assessment the CCP shall employ a defined and objective methodology that shall not fully rely on external opinions and that takes into consideration the risk arising from the establishment of the issuer in a particular country".*

We believe that the same approach should be followed for CSDs provided that they can rely on an external methodology (in line with our comments above).

12. CSD links - Article 48(10)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 48(3): "A link shall provide adequate protection to the linked CSDs and their participants, in particular as regards possible credits taken by CSDs and the concentration and liquidity risks as a result of the link arrangement.

A link shall be supported by an appropriate contractual arrangement that sets out the respective rights and obligations of the linked CSDs and, where necessary, of the CSDs' participants. A contractual arrangement with cross-jurisdictional implications shall provide for an unambiguous choice of law that govern each aspect of the link's operations."

Article 48(5): "A CSD that uses an indirect link or an intermediary to operate a CSD link with another CSD shall measure, monitor, and manage the additional risks arising from the use of that indirect link or intermediary and take appropriate measures to mitigate them."

Article 48(6): "Linked CSDs shall have robust reconciliation procedures to ensure that their respective records are accurate."

Article 48(7): "Links between CSDs shall permit DVP settlement of transactions between participants in linked CSDs, wherever practical and feasible. Detailed reasons for any CSD link not allowing for DVP settlement shall be notified to the relevant and competent authorities."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

Article 48(10): RTS on

(a) "the conditions as provided in paragraph 3 under which each type of link arrangement provides for adequate protection of the linked CSDs and of their participants, in particular when a CSD intends to participate in the securities settlement system operated by another CSD",

(b) "the monitoring and managing of additional risks referred to in paragraph 5 arising from the use of

intermediaries",
(c) "the reconciliation methods referred to in paragraph 6",
(d) "the cases where DVP settlement through CSD links is practical and feasible as provided in paragraph 7 and the methods of assessment thereof."

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.

ECSDA fully supports ESMA's approach, which treats standard and customised links equally from a risk perspective. This is in line with the approach taken in CSDR Level 1 text, in particular as regards the authorisation requirements for standard and customised links (Article 19).

We also agree in principle with the conditions for the establishment of standard and customised links. **The term "extensive" in point 3 of §190 is however unnecessary and should be deleted**, at least in relation to CSDs authorised or recognised under the CSDR. Given that the CSDR authorisation procedure is already extensive and covers all the aspects listed in §190, a further 'extensive' reassessment by the CSD itself should not be required. We recognise, however, that a more detailed analysis will usually be required for links with non-ESMA recognised third country CSDs.

Likewise, technical standards should take into account existing CSD link assessments, as performed under the Eurosystem framework, to avoid unnecessary duplication.

Finally, for the sake of consistency, §190 (bullet point 5) should explicitly refer to the *"measures that have been taken to ensure segregation* ***in line with CSDR article 38*** *(…)".*

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

Yes, we agree that the procedures proposed by ESMA for 'indirect links' are adequate.

Nonetheless, given that indirect links are not currently subject to such procedures, ECSDA recommends that **ESMA should foresee an additional delay of around 6 months for these requirements to enter into force**. This is because it will be difficult for those CSDs operating many indirect links in and outside Europe to have completed their reassessment all these links based on the new rules by the time they file their application for authorisation.

Q45: Do you agree with the elements of the reconciliation method mentioned above? What would the costs be in the particular case of interoperable CSDs?

Yes, we agree with ESMA's description of reconciliation methods in §196 of the Discussion Paper.

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, we agree description made by ESMA in §199 of the cases where DvP settlement can be considered practical and feasible.

With regard to §200 of the Discussion Paper, ESMA seems to indicate that both the requesting CSD and the receiving CSD need to offer banking services for DvP settlement to be possible across a link (at least when both CSDs are not in the same currency zone). This would suggest that DVP

settlement through links is often only possible in commercial bank money. In practice, it may however be possible to organise DVP settlement in central bank money (mostly when CSDs are in the same currency zone) without the CSD offering cash accounts and services (e.g. like in T2S). In such cases, the considerations in §200 would not be applicable.

13. Refusal of access to issuers - Article 49(5), (6)

WHAT THE LEVEL 1 REGULATION SAYS:
Article 49(3): "A CSD may refuse to provide services to an issuer. Such refusal may only be based on a comprehensive risk analysis or if that CSD does not provide the services referred to in point 1 of Section A of the Annex in relation to securities constituted under the corporate law or other similar law of the relevant Member State."
Article 49(4): "Without prejudice to [insert references to AML directive], where a CSD refuses to provide services to an issuer, it shall provide the requesting issuer with full written reasons for its refusal.
In case of refusal, the requesting issuer shall have a right to complain to the competent authority of the CSD that refuses to provide its services.
The competent authority of that CSD shall duly examine the complaint by assessing the reasons for refusal provided by the CSD and shall provide the issuer with a reasoned reply.
The competent authority of the CSD shall consult the competent authority of the place of establishment of the requesting issuer on its assessment of the complaint. Where the authority of the place of establishment of the requesting issuer disagrees with that assessment, any one of the two competent authorities may refer the matter to ESMA, which may act in accordance with the powers conferred on it under Article 19 of Regulation (EU) No 1095/2010.
Where the refusal by the CSD to provide its services to an issuer is deemed unjustified, the responsible competent authority shall issue an order requiring the CSD to provide its services to the requesting issuer."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 49(5): RTS on "the risks to be taken into account by CSDs when carrying out a comprehensive risk assessment, and competent authorities assessing the reasons for refusal in accordance with paragraphs 3 and 4, the elements of the procedure referred to in paragraph 4."
Article 49(6): ITS on "standard forms and templates for the procedure referred to in paragraph 4."

Q47: Do you agree that the risk analysis performed by the CSD in order to justify a refusal to offer its services to an issuer should at least include legal, financial and operational risks? Do you see any other areas of risk that should be considered? If so, please give examples.

We agree with ESMA's proposal as regards the type of risks that need to be taken into consideration in the risk analysis when justifying the refusal of an issuer by a CSD. A distinction of legal, financial and operational risks is reasonable. The examples provided by ESMA for each category are helpful indications, but they should not be considered as an exhaustive list. **It should also be clear that CSDs can, but do not have to, refuse issuers on these grounds.**

It is also important to note that technical standards will not affect the general right for CSDs provided in Article 49(3) of CSDR to refuse issuers in cases where the CSD does not provide notary services in relation to securities constituted under the law of the requesting issuer. This is an important safeguard since it protects CSDs from unnecessarily legal risks arising from differences in national law in relation to securities issues.

Moreover, we would like to highlight that CSDR only refers to the refusal of issuers. The case where

the CSD's refusal is limited to a particular issuance from one issuer is however also relevant. For example, a CSD may accept to offer notary services to an issuer for its fixed income securities but might not be equipped to notary services for its equities, for example because the CSD does not have access to the relevant feed from the CCP or trading venue, or because servicing equities would require it to set up a specific services such as withholding tax procedures. In order to cater for such cases, **ESMA should ensure that the proposed technical standards do not prevent CSDs from refusing news issues from an issuer for which it already provides notary services**.

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.

We agree with the time frames proposed by ESMA.

14. Refusal of access for CSD links - Article 52(3), (4)

WHAT THE LEVEL 1 REGULATION SAYS:
Article 52(2): "A CSD may only deny access to a requesting CSD where such access would threaten the smooth and orderly functioning of the financial markets or cause systemic risk. Such refusal can be based only on a comprehensive risk analysis."
Where a CSD refuses access, it shall provide the requesting CSD with full reasons for its refusal.
In case of refusal, the requesting CSD has the right to complain to the competent authority of the CSD that has refused access.
The competent authority of the receiving CSD shall duly examine the complaint by assessing the reasons for refusal and shall provide the requesting CSD with a reasoned reply.
The competent authority of the receiving CSD shall consult the competent authority of the requesting CSD and the relevant authority of the requesting CSD referred to in point (a) of Article 12(1) on its assessment of the complaint. Where any of the authorities of the requesting CSD disagrees with the assessment provided, any one of the authorities may refer the matter to ESMA, which may act in accordance with the powers conferred on it under Article 19 of Regulation (EU) No 1095/2010.
Where the refusal by the CSD to grant access to the requesting CSD is deemed unjustified, the competent authority of the receiving CSD shall issue an order requiring that CSD to grant access to the requesting CSD."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 52(3): RTS on "the risks to be taken into account by CSDs when carrying out a comprehensive risk assessment, and competent authorities assessing the reasons for refusal in accordance with paragraph 2 and the elements of the procedure referred to in paragraph 2."
Article 52(4): ITS on "standard forms and templates for the procedures referred to in paragraphs 1 to 3."

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.

In general, we agree with the time frames proposed by ESMA. We suggest however the following amendment to the last bullet point of §216:

"*Where the refusal by the CSD to grant access to the requesting CSD is deemed unjustified, the competent authority of the receiving CSD should issue an order requiring the receiving CSD to grant access to the requesting CSD. The CSD should be required to provide access to the requesting CSD*

through a standard link within 3-8 months of the order. ***Whenever the setup of the link requires developments (customised link), those costs would be at the expense of the requesting CSD (cf. point 218 b). The requesting and receiving CSDs will have to agree on the scope of development, cost and time frame as 8 months may not be sufficient for the developments****."*

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

Yes.

15. Refusal of access to other market infrastructures - Article 53(4), (5)

WHAT THE LEVEL 1 REGULATION SAYS:

Article 53(1): "When a CSD submits a request for access under Articles 50 and 51 to another CSD, the latter shall treat such request promptly and provide a response to the requesting CSD within three months."

Article 53(2): "A CSD may only deny access to a requesting CSD where such access would threaten the smooth and orderly functioning of the financial markets or cause systemic risk. Such refusal can be based only on a comprehensive risk analysis.

Where a CSD refuses access, it shall provide the requesting CSD with full reasons for its refusal.

In case of refusal, the requesting CSD has the right to complain to the competent authority of the CSD that has refused access.

The competent authority of the receiving CSD shall duly examine the complaint by assessing the reasons for refusal and shall provide the requesting CSD with a reasoned reply.

The competent authority of the receiving CSD shall consult the competent authority of the requesting CSD and the relevant authority of the requesting CSD referred to in point (a) of Article 12(1) on its assessment of the complaint. Where any of the authorities of the requesting CSD disagrees with the assessment provided, any one of the authorities may refer the matter to ESMA, which may act in accordance with the powers conferred on it under Article 19 of Regulation (EU) No 1095/2010.

Where the refusal by the CSD to grant access to the requesting CSD is deemed unjustified, the competent authority of the receiving CSD shall issue an order requiring that CSD to grant access to the requesting CSD."

Article 53(3): "ESMA shall, in close cooperation with the members of the ESCB, develop draft regulatory technical standards to specify the risks to be taken into account by CSDs when carrying out a comprehensive risk assessment, and competent authorities assessing the reasons for refusal in accordance with paragraph 2 and the elements of the procedure referred to in paragraph 2.

ESMA shall submit those draft regulatory technical standards to the Commission by nine months from the date of entry into force of this Regulation.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1095/2010."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:

Article 53(4): RTS on "the risks to be taken into account by CSDs when carrying out a comprehensive risk assessment, and competent authorities assessing the reasons for refusal in accordance with paragraph 2 and the elements of the procedure referred to in paragraph 2."

Article 53(5): ITS on "standard forms and templates for the procedures referred to in paragraphs 1 to 3."

Q51: Do you agree that the risk analysis performed by the receiving party in order to justify a refusal should include at least legal, financial and operational risks? Do you see any other

areas of risk that should be considered? If so, please give examples?

We agree with ESMA's proposal as regards the type of risks that need to be taken into consideration in the risk analysis when justifying the refusal of links with other market infrastructures. A distinction of legal, financial and operational risks is reasonable. The examples provided by ESMA for each category are helpful indications, but they should not be considered as an exhaustive list.

We note however that the CSDR foresees access from other market infrastructures to CSDs as well as access from CSDs to other market infrastructures. Limiting CSDR technical standards to specifying the conditions for the refusal of access of the CSD to other market infrastructures – and not covering the reverse situation – could result in a gap in the regulatory treatment of accesses between CSDs, CCPs and trading venues.

Q52: Do you agree that the time frames as outlined in the procedure above are sufficient and justifiable? If not, which time frames would you prefer? Please provide reasons to support your answer.

We agree with the time frames proposed by ESMA.

16. Procedure to provide banking type of ancillary services - Article 55(7), (8)

WHAT THE LEVEL 1 REGULATION SAYS:
Article 16(4): "As from the moment when the application is considered to be complete, the competent authority shall transmit all information included in the application to the following authorities:
(a) The relevant authorities referred to in Article 12(1);
(b) The relevant competent authority referred to in Article 4 (4) of the Directive 2006/48/EC;
(c) the competent authorities in the Member State(s) where the CSD has established interoperable links with another CSD except where the CSD has established interoperable links referred to in Article 19(5);
(d) the competent authorities in the host Member State where the activities of the CSD are of substantial importance for the functioning of the securities markets and the protection of investors within the meaning of Article 24(4);
(e) the competent authorities responsible for the supervision of the participants of the CSD that are established in the three Member States with the largest settlement values in the CSD's securities settlement system on an aggregate basis over a one-year period;
(f) ESMA and EBA."

WHAT THE LEVEL 2 TECHNICAL STANDARDS SHOULD SPECIFY:
Article 55(7): RTS on "the information that the CSD shall provide to the competent authority for the purpose of obtaining the relevant authorisations to provide the banking services ancillary to settlement."
Article 55(8): ITS on "standard forms, templates and procedures for the consultation of the authorities referred to in paragraph 4 prior to granting authorisation."

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

Yes, we agree.

Q54: What particular types of evidence are most adequate for the purpose of demonstrating that there are no adverse interconnections and risks stemming from combining together the two activities of securities settlement and cash leg settlement in one entity, or from the

designation of a banking entity to conduct cash leg settlement?

We do not believe that *"the investment policy of the credit institution"* (§235) is relevant information for the purpose of this article, as the credit institution will be subject to CSDR articles 54 and 59 and to the limitations included in Section C of the CSDR Annex.

Furthermore, we note that a *"service level agreement"* is only part of the elements to consider in case of outsourcing. The entities should demonstrate compliance with the general outsourcing requirements included in CSDR and the banking legislation.

Additional elements to be considered are:

- The need for prompt access of the credit institution to the securities collateral related to its short term credit provision (i.e. this collateral will be located in the CSD);
- The alignment of recovery and resolution arrangements of the two or more legal entities;
- The need to address possible conflicts of interest in the governance arrangements of the respective entities.