DACSI

Consultation response

DACSI **15-1004**

From : DACSI (prepared by AHG CSDR Consultations 2015)

Subject : **Reply to the ESMA Consultation on Technical Standards under the CSDR**
version 2.0 (as submitted)

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What follows is the final text of DACSI's response to ESMA's Consultation Paper "Technical Standards under the CSD Regulation" (DACSI 14-2373).

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

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

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

No, DACSI does not think these are adequate.
Using different deadlines dependent on the time zones of the relevant investment firms would introduce unnecessary complexity. We recognise that time zone differences are often incompatible with "same day" allocation and confirmation, but when taking this into account simplicity and harmonisation require a general market practice for the confirmation/allocation process: this should be at the latest at 11 am GMT / noon CET on the business day following the trade day.

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

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

Yes, DACSI agrees with these cases, with two exceptions:

- the proposed wording for Article 3(2) **sub a** is not as precise as it could be and could have some unintended consequences; sub a should rather read "the settlement instructions received by the CSD are already matched **by trading venues, CCPs or other entities**;"

- the proposed wording for Article 3(2) **sub b** could suggest that prior matching is mandatory for FoP instructions between accounts in the name of different participants but operated by the same account operator. It is highly desirable that the exception of sub b is also applicable in these cases, because this is operationally equivalent to settlements between accounts of the same account holder.
  Hence we propose that sub b will read "FoP instructions consisting of transfers of financial instruments between different accounts opened in the name of the same participant**, or managed by the same (mandated) account operator**."

In order to harmonise cross-border situations DACSI recommends that ESMA defines **one tolerance level per asset type/instruction** which should be used **by all CSDs**. The currently prevailing levels in the T2S system would be fully adequate:
- € 2 for settlement amounts up to € 100.000,
- €25 for higher amounts.

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

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

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

DACSI is of the opinion that all CSDs should offer the same **standard** measures to encourage and incentivise the timely settlement of transactions. Hence, the requirements under paragraphs 5 and 7 should apply **for all CSDs**.

Participants in multiple CSDs (and their clients) have a strong interest in harmonised regimes for all CSDs: any exception for a CSD would necessitate extra (complicated) facilities at the settlement agent level and can easily interrupt STP processing. In particular, mechanisms like hold/release and recycling are considered necessary for achieving a low fails rate throughout the chain, no matter the size of the CSD.
More principally: if a chain of interdependent settlement instructions would involve both a "regular" CSD (with a hold/release mechanism (par. 5) and with the possibility of partial settlements (par. 7)) and a "small or highly efficient" CSD (with exceptions for these mechanisms) and fail(s) would occur in such a chain, the exception would imply unwanted disruptions in the processes between the two (kinds of) CSDs and would have a negative impact on the timely settlement of a transaction.

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

DACSI notes the following on the proposed Articles 2 and 3:

- Allocations and confirmations as dealt with in these articles are essential for efficient settlement and should therefore be addressed in this CSD Regulation as such. However, settlement agents cannot be held primarily responsible for allocations and confirmations. In essence, they deal with the trades and the intermediary roles around trading (broker, clearing member). In our opinion, these obligations should be included in MiFID II/MiFIR as well and/or should be cross-referenced.
- Article 3(2) after sub b now reads "CSDs shall require that CCPs send already matched settlement instructions into the securities settlement system operated by a CSD, unless letter b) of subparagraph 1 applies.". Evidently, reference should be made to **letter b) of subparagraph 2**.

Transaction types as mentioned in Article 4(2) sub e could be part of the CSD's monitoring system.
Currently however, this data field is neither a mandatory field nor a matching field in the settlement message. To include this data field as a mandatory and matching field in the settlement message would require extensive and very costly amendments in systems and procedures through the settlement chain. If they would be included, such would not contribute to reducing settlement fails because transacting parties and their agents may have different drivers for and perceptions of (the transaction type of) a settlement instruction.

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

DACSI does not entirely agree with the proposed articles 4-6.

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In addition, DACSI believes that corporate actions and custody related operations (sub e under (iv)), are not triggered by a settlement instruction, but by a corporate event announced by the Issuer or mandated agent or by custody position account sweeps.

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

Yes, DACSI agrees.
With regard to the (re)distribution of penalties: DACSI is in favour of a standard for all CSDs whereby the **net** penalty amount will be charged, collected and redistributed **on a daily basis**. Accumulation on a monthly basis - as proposed in Article 8(2) - would not reduce the workload, but would make the reconciliation and the eventual correction of errors more cumbersome. Another unintended consequence would be that intermediaries should pre-finance penalty fees.

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

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

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

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

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

In more detail DACSI wants to comment:

Re Article 11(3): we agree with the provision that the ‘related settlement instruction shall be deemed executed’ when the related securities are delivered following the buy-in. However, the original (failed) settlement instruction will keep its **‘failed’ status**, unless changed explicitly. We propose it is the CSD‘s responsibility to cancel the original instruction.

The CCP that guaranteed the settlement of a trade as a principal should manage its own buy-in process; this buy-in is not the responsibility of a CSD. The CCP should follow the CSD standards for the buy-in.

The receiving participant (in case of an omnibus accountholder on CSD level) is not always the principal of the failing settlement; in this case the buy-in will be executed on behalf of the failing counterparty of the underlying trade of the failed settlement (trading level) .

Re Article 11(5): this provides that the CSD shall reserve the relevant financial instruments available in the failing participant's account for the settlement of that instruction. DACSI underlines that this is not viable for an **omnibus account**, because the position of an omnibus account is the sum of all related client positions.

Re Article 11(7): this provides for **partial buy-ins** and complementing cash compensations. DACSI is not in favour of partial buy-ins, as they would add substantial complexity to the intermediary chain. On trading level the counterparties could opt out in the conditions of the trade for partly settlement, which also means an opt-out for partial buy-ins.

Additional comments:

For traded financial instruments that are terminated as part of the instrument terms (i.e. redeemable bonds, convertible bonds, warrants, turbos, etc) an actual buy-in of the non-settled securities will not be possible after several days because these securities do not exist anymore. Only a cash compensation will be possible in these cases.

In any case of **redemption or expiration** an actual buy-in of the non-settled securities will not be possible after several days because these securities do not exist anymore. Only cash compensation will be possible.

The proposed buy-in process is described for failed settlement due to missing securities only. A description in case of **failure due to a lack of cash** is absent. We are of the opinion that a **'sell-out' process** is to be designed and included in the RTS that should mirror the buy-in process as much as possible.

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

In DACSI's view **all timeframes** should be **standardised** in order to minimise complexity and maximise transparency of processes. Hence, timeframes should be independent of instrument types or other attributes.

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

DACSI agrees with the proposal.

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

DACSI wants to comment re Article 15 (C) (par. 103): it is not obvious that in each described case a third party (buy-in agent) can be found for determining a price in due time (e.g. non-liquid financial instruments); in these cases DACSI will recommend a cash compensation based on the original price of the failing trade.

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

DACSI's thinks the basis of the calculation should not be on participant level but on the trading party level; the participant is not the principal of the trade and for that reason cannot be held responsible for a trading party's consistent and systematic failure.

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

DACSI agrees with the proposal.

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

DACSI has no comments.

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

No, DACSI does **not agree** and wants to comment that more guidance is needed in the RTS for one European standardised and harmonised penalty regime. Otherwise, CSDs participants will be confronted with multiple not fully harmonised and standardised systems; such would face participants with much higher development and operational costs. DACSI is in favour of a **big bang** approach to implement this regime after wave 4 of T2S.

We would therefore recommend that a longer period of time may be allowed for the full implementation of the new settlement discipline measures, at least up to one full year after the completion of the T2S migration (i.e. at least up to end of Q1 2018, or up to end of Q2 2018 in case of use of the emergency migration wave). In order to minimize complexities we strongly favour a **big-bang** implementation rather than a phased one.

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

DACSI understands the logic behind reporting the aggregated volume and value of internalised settlements to the competent authorities. We support any measures that could help identifying, monitoring and addressing the potential risks that may result from the practice of internalised settlement. We however believe that any such measures should be practical and proportionate and should not go beyond what is strictly necessary to meet the objective of the primary legislation (level 1 text), i.e. the data to be collected should be reduced to the minimum to what is considered as useful and meaningful information for the purpose of the transparency objective in the CSDR. In this respect, we believe that the list of reporting requirements of the Consultation Paper will not only be burdensome for many financial institutions, but could also be detrimental for the customers.

Content of Report (expanding on the above)

- *Type of securities transactions*
  The identification of the type of operations should exclusively relate to the standard transaction types (i.e. DF/RF/DVP/RVP). Custodian banks do not always know the true background of the transactions: they only see the settlement instruction in its standard form, i.e. according to the type of operations mentioned above. An identification per financial instrument as regards the type of operations - such as repos, securities lending, collateral management, etc. - is not possible nor feasible. For the same reasons that CSDs cannot provide details of the trade, the settlement internalisers will not be in a position to provide such details either.
  In addition, corporate actions and custody related operations are not triggered by a settlement instruction or a transfer order, but by a corporate action announced by the Issuer or mandated agent. This kind of instruction should be exempted from reporting.

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- *Type of clients*
  ESMA also requests for a split per type of client. Does this mean the client we (as custodian) have a contract with or the customer of our client since a custodian may hold segregated accounts for customers of its clients in its books?
  If ESMA means the former (the custodian's client), the report wouldn't be correct as the trades would not be reported to the correct entity.
  If ESMA means the latter (the customer of a client), then in the majority of the cases we wouldn't have the documentation to classify the customer as we are not contractually related with.
  The type of client may not be a category which will provide accurate data in order to be included in the report.
- *Scope*
  The scope in respect of the securities should be made more specific: only securities issued in a Central Securities Depository operating in a Member State of the European Union should be subject to the reporting obligation.
- *Format of the reports*
  Although ESMA provides as appendices the draft format of the reports, the description provided is not enough and it is not clear how the reports will actually look like. This leaves room to the respective authorities to come with their own specific template. This is also what happened with EMIR reporting. A standard template across all NCAs is critical to ensure one system built and no duplication of effort.
- *Time of implementation and submission of the first report*
  The proposed report is very detailed and would require a systems build/enhancement from the settlement internaliser in order to be able to produce the two reports proposed by ESMA, so an additional concern is around timing of implementation. The timeframe between the finalisation of requirements and the first report submission won't be enough to enable system enhancements, report building and testing to be ready for the first reporting on time. A phase-in period should be considered.
- *The second report including failed transfer orders*
  *A*rt 9.1 of CSDR provides that settlement internalisers report "the aggregated volume and value of all securities transactions that they settle outside securities settlement systems." However, in art 2(j) of the draft RTS, ESMA intends to ask settlement internalisers to report also:
  - the number and value of failed transfer orders, knowing that a "transfer order" defined in Directive 98/26/EC includes cash and securities settlements through a securities settlement system, and
  - a comparison of the settlement fails that occur as part of settlement internalisation and the settlement fails in the system.

  This goes beyond the mandate given to ESMA under art. 9.2 of CSDR. We therefore advocate the deletion of art. 2(j) of the draft RTS, as the reporting in number and value of the transactions is already included in articles 2(f) and 2(g). In addition, this requirement corresponds to none of the fields in the annexes of the draft ITS.