Guidelines on Internalised Settlement Reporting under Article 9 of CSDR

The NL market's response to ESMA's consultation of 10 July 2017 (ESMA70-151-457)

Date   14 September 2017

DACSI (the Dutch Advisory Committee Securities Industry) is the principal trade association in The Netherlands for firms active in the securities industry. The association represents the interests of its members as users/clients of infrastructure providers in the field of securities, e.g. exchanges, central counterparties, central securities depositories. With 12 members, DACSI represents the vast majority of the banks active in The Netherlands, and positions the Dutch view to the market infrastructure service providers and the regulatory authorities in The Netherlands and the European Union.

General remarks

The Dutch Market, represented by DACSI, is glad to provide its view in response to ESMA's consultation with the aim to find the best possible compromise between the intended regulatory objective - being safe and sound markets and transparency of where potential risks lie - on the one hand and pragmatic implementation requirements on the other hand.

Based on ESMA's intention to finalise guidelines by Q1 2018, the Industry would need to have clarity on required fields and formats at an early stage to accommodate institutions' own systems development, tests and release cycles. In particular, further clarification and/or confirmation is required on some items.

Therefore we:
1. propose to publish a basic diagram that can help institutions in determining whether it should include a particular transaction in its CSDR reporting,
2. emphasise the need for the XML report scheme, for both the Settlement Internalisers and the NCAs in regard to their preparation.

With regard to the first item the following simple example of a diagram can be considered:
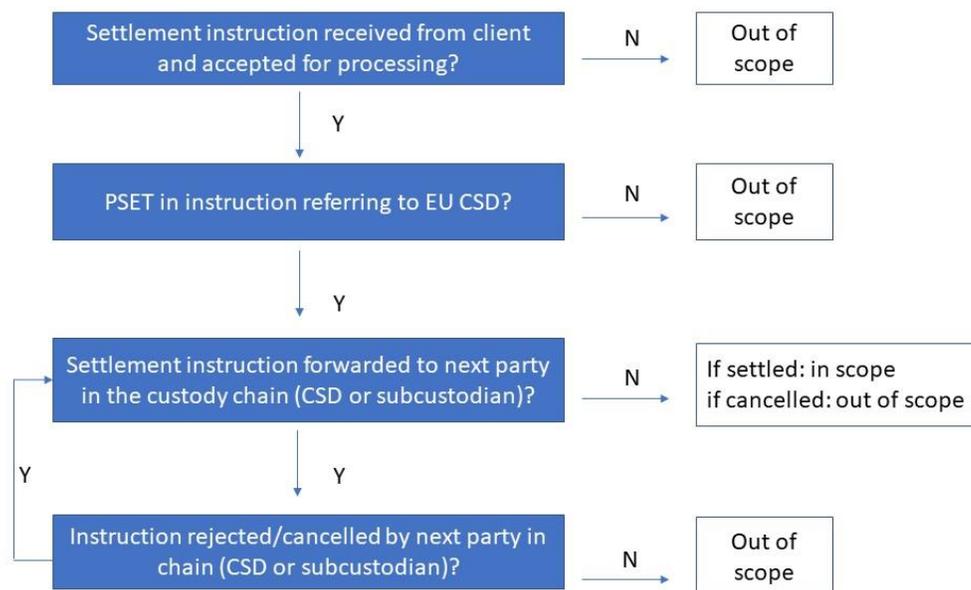
Chapter 4 - Reporting

Q 1   Do you have any comments or suggestions regarding the scope of the data to be reported by settlement internalisers? Please provide arguments supporting your comments and suggestions.

DACSI believes that "transaction type" is relevant for the creation of the report by means of categorising into the relevant RTS category. However, we note that the Settlement Internaliser, being dependent on the information provided by the instructing party in its instruction, does not have sufficient information to dispute the transaction type

used. Most communication takes place via ISO messages, in which the ISO transaction identifier is included as a mandatory field, which in turn is mapped into the respective RTS category by the Settlement Internaliser.

When the client instruction is provided in a non-ISO format (fax or other communication), the transaction type may be missing. If such cases we propose mapping such instruction into the RTS "Other securities transactions".

Based on the existing standards for Transaction Types in ISO compliant messages the following values are possible. We have classified them into the respective category outlined in Regulation 2017/391 as per our understanding and would appreciate ESMA's feedback on the below categorisation:

TransType	Description	Long Description	Relevant Category of RTS
BSBK	Buy Sell Back	Relates to a buy sell back transaction.	Repurchase transactions
CLAI	Market Claim	Transaction resulting from a market claim.	Not in scope of SI reporting
CNCB	Central Bank Collateral Operation	Relates to a collateral delivery/receipt to a National Central Bank for central bank credit operations.	Collateral management operations
COLI	Collateral In	Relates to a collateral transaction, from the point of view of the collateral taker or its agent.	Collateral management operations
COLO	Collateral Out	Relates to a collateral transaction, from the point of view of the collateral giver or its agent.	Collateral management operations
CONV	DR Conversion	Relates to a depository receipt conversion.	Other securities transaction
ETFT	Exchange Traded Funds	Relates to an exchange traded fund (ETF) creation or redemption.	Not in scope of SI reporting
FCTA	Factor Update	Relates to a factor update.	Other securities transactions
INSP	Move of Stock	Relates to a movement of shares into or out of a pooled account.	Other securities transaction
ISSU	Issuance	Relates to the issuance of a security such as an equity or a depository receipt.	Not in scope of SI reporting
MKDW	Mark-Down	Relates to the decrease of positions held by an ICSD at the common depository due to custody operations (repurchase, pre-release, proceed of corp. event realigned).	Other securities transaction
MKUP	Mark-Up	Relates to the increase of positions held by an ICSD at the common depository due to custody operations (repurchase, pre-release, proceed of corporate event realigned).	Other securities transaction
NETT	Netting	Relates to the netting of settlement instructions.	Other securities transactions
NSYN	Non Syndicated	Relates to the issue of medium and short term paper (CP, CD, MTN, notes ...) under a program and without syndication arrangement.	Not in scope of SI reporting

TransType	Description	Long Description	Relevant Category of RTS
OWNE	External Account Transfer	Relates to an account transfer involving more than one instructing party (messages sender) and/or account servicer (messages receiver).	Other securities transaction
OWNI	Internal Account Transfer	Relates to an account transfer involving one instructing party (messages sender) at one account servicer (messages receiver).	Other securities transaction
PAIR	Pair-Off	Relates to a pair-off: the transaction is paired off and netted against one or more previous transactions.	Other securities transaction
PLAC	Placement	Relates to the placement/new issue of a financial instrument.	Purchase or Sale of securities
PORT	Portfolio Move	Relates to a portfolio move from one investment manager to another and/or from an account servicer to another. It is generally charged differently than another account transfer (OWNE, OWNI, INSP), hence the need to identify this type of transfer as such.	Other securities transaction
REAL	Realignment	Relates to a realignment of positions.	Other securities transaction
REDI	Withdrawal	Relates to the withdrawal of specified amounts from specified subaccounts.	Other securities transaction
REDM	Redemption (Funds)	Relates to a redemption of Funds (Funds Industry ONLY).	Not in scope of SI reporting
RELE	DR Release/ Cancellation	Relates to a release (into/from local) of Depository Receipt operation.	Other securities transaction
REPU	Repo	Relates to a repurchase agreement transaction.	Repurchase Transaction
RODE	Return of Delivery	Without Matching Relates to the return of financial instruments resulting from a rejected delivery without matching operation.	Other securities transaction
RVPO	Reverse Repo	Relates to a reverse repurchase agreement transaction.	Repurchase transaction
SBBK	Sell Buy Back	Relates to a sell buy back transaction.	Repurchase transaction
SBRE	Borrowing Reallocation	Internal reallocation of a borrowed holding from one safekeeping account to another.	Securities lending or borrowing
SECB	Securities Borrowing	Relates to a securities borrowing operation.	Securities lending or borrowing
SECL	Securities Lending	Relates to a securities lending operation.	Securities lending or borrowing
SLRE	Lending Reallocation	Internal reallocation of a holding on loan from one safekeeping account to another.	Securities lending or borrowing

TransType	Description	Long Description	Relevant Category of RTS
SUBS	Subscription (Funds)	Relates to a subscription to funds (Funds Industry ONLY).	Purchase or sale of securities
SYND	Syndicate of Underwriters	Relates to the issue of financial instruments through a syndicate of underwriters and a Lead Manager.	Not in scope of SI reporting
TBAC	TBA Closing	Relates to a To Be Announced (TBA) closing trade.	Purchase or sale of securities
TRAD	Trade	Relates to the settlement of a trade.	Purchase or sale of securities
TRPO	Triparty Repo	Relates to a triparty repurchase agreement.	Repurchase transaction
TRVO	Triparty Reverse Repo	Relates to a triparty reverse repurchase agreement.	Repurchase transaction
TURN	Turnaround	Relates to a turnaround: the same security is bought and sold to settle the same day, to or from different brokers.	Purchase or Sale of securities

Our feedback to particular items under §§ 11 and 12:

DACSI agrees with the overall considerations, provided that the criteria of an internal settlement are met and qualified as such by the instructing party in its instruction. However, we do not (fully) agree with particular subparagraphs:

§§ 11.e and 12.g: We think that the term "netting" needs further clarification. A pair-off should not be relevant for the internalisation reporting, as long as a part of the involved chain is settled externally via the CSD. In this case, the pair-off is executed to prevent failure of settlement, which might be caused by two trading parties who both are at risk of failing to each other. This is illustrated as follows:
Client A of a bank has a purchase of 50 and a sale instruction of 100 shares with the same counterparty B at a different bank. Client A already holds 50 shares in his account, so technically his position is flat. B has no initial position, but is actually long, as he bought 100 shares to A and sold 50 of those to A. The four instructions would be issued through the respective custodians to the CSD for settlement. However, since Client A does not hold the full delivery position of 100 shares the custodian of A would put the instruction on hold until the purchase of 50 shares would settle. This on the other side would not occur since counterparty B holds no position. These two trades would therefore remain open.
In order to settle all four transactions, operations staff would agree between the different counterparties to settle only the excess of 50 shares against the difference in Cash amount of the 100 shares and the 50 shares. This would then be reinstructed in the CSD and subsequently settled. The clients would receive the confirmation on both their respective instructions.

Evidently, a full pair-off, whereby cash settlement takes place outside the CSD, remains to be reported as internal settlement. Operationally, it is necessary that full pair-off and partly pair-off situations are reined by the same process.

Concluding, we suggest to delete § 11.e, as these transactions would typically also appear under a – d from a transaction type and the Internaliser would net those technically. § 12.e should only state "transactions that are settled by a CSD and transactions that are cleared by a CCP".

§ 11.f: We agree, assuming that "funds" is to be read as "investment funds".

§ 11.m: DACSI does not agree. A transformation consists of the cancellation of a failed/unsettled transaction, which has to be cancelled, and the creation of a new (replacing) transaction. The unsettled/cancelled instruction is out of scope and the new transaction, as soon as it will settle, will be in scope, but subject to meeting the conditions of an internal settlement. However, such would be covered already by § 11.a-d, so there is no need to include the current subparagraph.

§ 12.d: We agree. However, some clients may maintain several accounts with a Settlement Internaliser, whereby it may not always be fully transparent whether there is a change at the level of Ultimate Beneficial Owner (UBO) or not. Both in case where the instructing party instructs to transfer/settle within one securities account of two securities accounts at the Settlement Internaliser. It is not a market practice – and generally not supported technically – to include UBO change parameter(s) in instructions.

The reporting obligation should always be the responsibility of an account service provider and never of the account holder on the top of the pyramid (the ultimate shareholder/beneficial owner).

§ 12.g: We agree, but believe that the second part of the sentence starting with "however" should be deleted, referring to item § 11.e above.

§ 13: DACSI agrees, but suggests ESMA to include the below additions, given the proposal to determine a transaction in scope based on details to provide in the client instruction:

a) Financial instruments that are initially recorded or centrally maintained in CSDs authorised in the EU, *provided that the initiating client instruction indicates that the transaction should settle in a EU CSD;*

b) Financial instruments initially recorded an/or centrally maintained outside of CSDs authorised in the EU but *can be* settled in an EU CSD, *provided that the initiating client instruction indicates that the transaction should settle in a EU CSD.*

Since "client instruction" is one of the criteria for an (internal) settlement being reportable or not, we consider it reasonable for the Settlement Internaliser to determine an instruction to be in or out of scope based on the PSET as provided by the instructing party.

§ 14: We agree with ESMA's suggestion as long as the Place of Settlement indication as described above may be applied. We understand that this is meant as additional clarification to "in-scope instruments", whereby a financial instrument will have to be eligible at a CSD.

Q2   Do you have any comments or suggestions regarding the entities responsible for reporting to competent authorities? Please provide arguments supporting your comments and suggestions.

§ 15: DACSI agrees with the first paragraph of § 15. In terms of clarity, we think that the example provided should avoid the term technical subaccount, which could be misunderstood, and we propose the following picture:
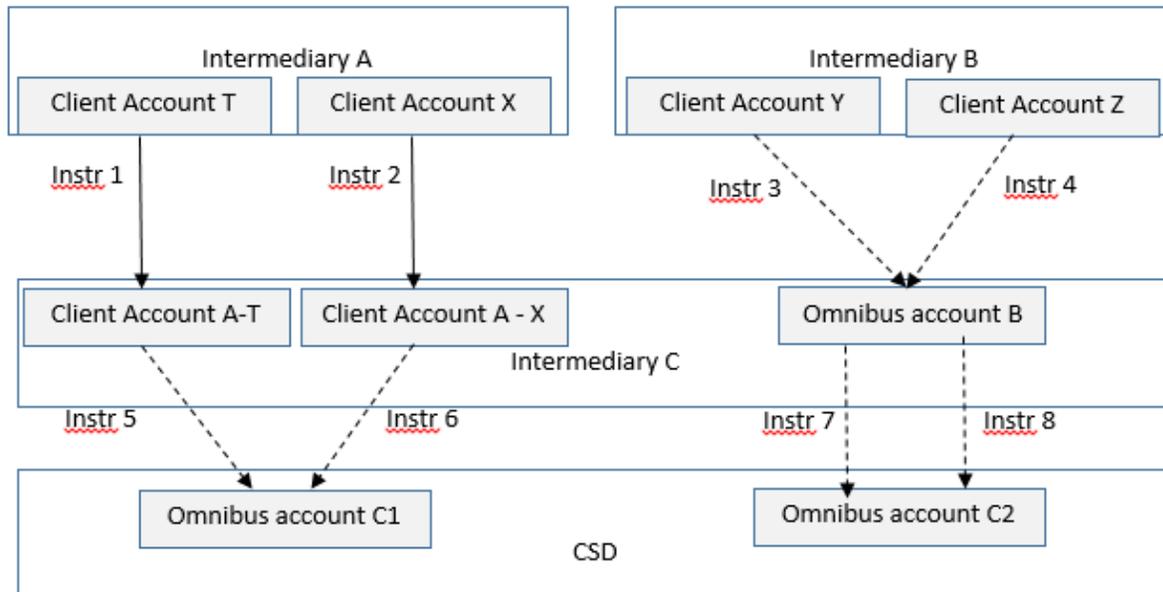
In this example:
- the non-dotted lines are instructions required to be sent from one party to another party in order to establish settlement.
- the dotted lines reflect that settlement at the next level is not necessary, since the instructing party can choose to internalise the instruction(s).
- if such party does internalise, and the other in-scope criteria are met, such transactions are in scope.
- meaning:
  - Intermediary C has to report instructions 1 and 2 if it will settle instructions 1 and 2 without sending them to the next party in the chain (in this example the CSD).
  - Intermediary C has to report instructions 3 and 4, if received, and if it will settle instructions 3 and 4, without sending those to the next party in the chain (in this example the CSD).
  - if Intermediary C will send the instructions onwards to the CSD (represented in the diagram by instructions 5, 6, 7 and 8), than no party will report such as internal settlement.
  - if Intermediary B will not send instructions 3 and 4 to B, Intermediary C cannot report (since it is unaware of the movement within the administration of Intermediary B). It is Intermediary B who should than report subject to the other criteria.

In addition, we highlight that there may be scenarios where accounts maintained at a CSD are operated by another party than the account owner. In such a scenario the account operator would only receive the instructions to update the internal records; however, the account owner will make the choice whether to internalise or not. We agree that in the case of account operator set-ups, the account operator can provide information to the account owner to complete his legal obligation; however, this should be done on reasonable commercial terms.

§ 16: We agree with ESMA's view and interpret the "competent authority" as the one referred to in Article 11 of CSDR and published on ESMA's website.[1]

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[1] https://www.esma.europa.eu/sites/default/files/library/esma70-708036281-159_csdr_list_of_competent_authorities_art_11.pdf

§ 17: We share ESMA's view that that no settlement internalisation reporting is required for transactions that are internalised in third-country branches, irrespective of the underlying instrument.

We also note that the draft Guidelines suggest – in §§ 17 and 20 – that there is no reporting obligation for branches (of EU entities) that are located outside the Unions. We support this interpretation and suggest that ESMA makes this implicit in the final Guidelines.

Q3   Do you have any comments or suggestions regarding the proposed data reporting parameters? Please provide arguments supporting your comments and suggestions.

§ 21: DACSI does not agree. As mentioned elsewhere in our response, we propose/suggest to use the respective CSD, to determine the need to report (or not), based on the Place of Settlement as provided in the client instruction. However, the Place of Settlement (in case of internal settlements per definition equal to Place of Safekeeping) may not be the Issuer CSD, but an Investor CSD. Determining the Issuer CSD is adding unnecessary complexity for the Settlement Internaliser. We kindly request ESMA to reconsider and/or provide clarification why categorizing at Issuer CSD country code opposed to the true PSET CSD country code (Issuer or Investor CSD) would be beneficial for ESMA.

Deriving the Country Code from the first two characters of the ISIN can give wrong or inconsistent results. Several ISINs exist for which the first two characters are not linked to the (current) Issuer CSD.
We propose using the Country Code derived from the CSD being reported.

§ 22: We agree to have the distinction between XS and EU ISINs; however, a similar issue could arise for any EU or non-EU security that is eligible at the International CSDs (Settlement Internalisers may not register Issuer CSDs). Please also refer to our comments on § 21.

§ 25: We strongly disagree for the following reasons:
i) The regulation (art 2 of the Regulation 2017/391) stipulates settled transactions to be reported. Any pending failed transaction is per definition "unsettled" and should therefore be considered out of scope. Any instruction which has an actual settlement date later than the intended settlement date should be considered as failed and to be included in the failed column.
ii) Application of the intended settlement date determining the period in which a transaction is to be reported generates unnecessary complexity for the Settlement Internaliser, the NCAs and ESMA. The Settlement Internaliser may receive late (internal) instructions with an Intended Settlement in a previous reporting period, which would result in corrections. Making use of the actual settlement, which is always done for settled transactions, would avoid such complexity.

§ 27: We have interpreted the first reporting period in the same way as ESMA has done, however we would like to stress, that this kind of reporting is something new and it would be desirable to cater for a testing period between competent authorities and internalisers to ensure, that (i) data can be received and (ii) the data is complete and matches the expectations of the authorities. While not specifically mentioned in the draft guidelines, we assume that in order for a report to be successfully transmitted to the NCA, it will be sufficient if it has been submitted before the end of the day.

Moreover, given the required time to programme the reports it would be highly appreciated if the Guidelines could be finalised as early as possible and ahead of Q1 2018 to give internalisers sufficient time and clarity to finalise their projects ahead of the reporting deadlines.

Q 4 **What are your views regarding the proposed requirement according to which settlement internalisers should use an XML format based on the ISO-20022 compliant XSD schema?**

DACSI supports the use of machine-readable format, and agrees that this reporting should be implemented in a future proof standard to avoid later adjustments (and consequential investments). However, we emphasise the need to receive the scheme (and examples) as early as possible; IT programmes for Settlement Internalisers are already overloaded.

Q 5 **Do you have any comments or suggestions regarding the proposed process for submission of internalised settlement reports? Please provide arguments supporting your comments and suggestions.**

We believe it would be beneficial if ESMA would include a similar section describing the process for the submission of internalised settlements report by the Internaliser to the competent authority.

The Dutch market would welcome a single connectivity solution for all parties involved, preferably in a push solution. Such would avoid the need for onward sending between different entities, where required.

Q 6 **Do you have any additional comments or suggestions regarding the proposed guidelines? Please provide arguments supporting your comments and suggestions.**