Post-trade made easy

22 May 2014

ESMA Discussion Paper on Draft Technical Standards for the CSD Regulation

Euroclear SA/NV response

Euroclear welcomes the comprehensive Discussion Paper issued by ESMA on the Draft Technical Standards for the CSD Regulation ("CSDR"). We await the future consultation from ESMA on the penalties for settlement fails and the process for collection and redistribution of such penalties. In this response, we already offer ESMA some views on these aspects.

This response covers the views of all (I)CSDs within the Euroclear Group. However, Euroclear is also a Board Member of ECSDA and chairs its Public Policy Working Group and has, as a consequence, been extremely closely involved in the production of ECSDA's comprehensive consultation response. ECSDA has undertaken a detailed review of the Settlement Discipline and Buy-In measures in Articles 6 and 7 of the CSDR and Euroclear broadly concurs with the views contained in the ECSDA response. Euroclear's response should therefore, be read in close conjunction with that of ECSDA.

This consultation response follows the order of the ESMA Consultation paper, but is divided into two separate sections with two separate Executive Summaries:

Pages 2-18	**Questions 1-20 (relating to CSDR Articles 6 and 7 ONLY)**
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Pages 43-46	**Annex 1 Euroclear Proposed changes to the ESMA text on record-keeping**
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PART 1 Executive Summary

(Questions 1-20 on Articles 6 and 7 only)

1. **Euroclear supports the concept of a unified settlement discipline regime across the EU (particularly in the context of the launch of T2S). However, the current very low level of settlement fails indicates that they pose no significant or systemic risk to European securities markets.** In March 2012, the settlement efficiency rate (as calculated by ECSDA[1] and measured by the number of transactions which settle by the end of ISD) was 98.9% in value terms and 97.4% in volume terms which represented an increase of 1.5 to 2 percentage points (in value/volume) compared to 2009 figures. Of the 1.1% of transactions that fail to settle on time by value, most will settle the following day, with a settlement fail rate of less than 0.5% on ISD+1. As a consequence, ESMA should approach the definition of the Technical Standards for Article 6 and 7 proportionately, ensuring that the scope of the regime and the size of the penalties are appropriate to the very low level of fails in Europe.

2. **We believe there is a need for a study of the potential effects of a mandatory and highly prescriptive and rigid settlement discipline and buy-in regime on (i) the wide range of securities required by the CSDR and (ii) on the competitive landscape for CSDs.** We are concerned that the measures set out in the CSDR to manage settlement fails are limited just to CSDs (e.g. Article 6(2) and (3)) which could lead to a migration of international business away from CSDs and an increase in internalisation of domestic securities on the books of intermediaries, which are not subject to the CSDR. This is an issue that affects all CSDs in the EU. Another risk of a very prescriptive regime is the lack of flexibility of being able to adjust the regime quickly and effectively to take into account specific market events or evolutions. Given the absence of a detailed impact assessment of the proposed regime, we believe that ESMA should adopt a flexible approach to the specification of the regime.

3. **The implementation of the settlement discipline measures under the CSD Regulation should be phased or delayed until after the implementation of T2S.** ESMA should not underestimate the scale of the changes required in the systems of CSDs and market firms to accommodate a harmonised settlement discipline regime (e.g. static data changes, introduction of new messages, new billing mechanisms, etc.). A typical IT project would only begin once the full specification of the changes is known (which is when the ESMA Technical Standards and Commission Delegated Acts are finalised in mid 2015). From that point a minimum of 18 months for the design, development, internal and external testing would be required before the implementation of the regime.

[1] http://www.ecsda.eu/uploads/tx_doclibrary/2012_09_18_ECSDA_Statistical_Exercise.pdf

Consequently, we believe that the only realistic timeline for CSDs to implement fully the settlement discipline standards is after the final T2S migration wave is completed. ESMA should note that the IT road maps of those CSDs (or CSD Groups) which are joining T2S are completely full until at least their migration to T2S, and are likely to be significantly consumed with post-migration activities, at least until such time as the final migration wave has occurred.

4. **Technical aspects of settlement (such as matching standards, message standards or number of settlement batches) should not be included in binding Technical Standards.** Technical standards should be designed to be "future-proof" and should avoid referring to specific technical settlement solutions or standards, which may soon become outdated. Constraining market development and evolution through overly prescriptive Delegated Acts and Technical Standards could well damage the competiveness and effectiveness of settlement infrastructure in Europe.

5. **CSDR technical standards should establish a set of tools that CSDs could choose to employ in order to prevent settlement fails. Which tools to be used at which stage would be a decision for each CSD in consultation with its market and in particular with its Competent Authority.** 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 for all instrument types and markets. CSDR technical standards should provide a common basis for all CSDs, while allowing CSDs to pick the most appropriate tools 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, which states 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 Matching Standards of 2006**[2]. However not all of those market standards are suitable for translation 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. **The mandatory nature of both the buy-in regime and the settlement discipline regime means that there is a real risk that intermediaries in a chain of transactions will be subject**

[2] 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)

to multiple buy-ins and multiple settlement penalties. ESMA recognises this risk in its consultation paper, but the market has yet to find a cost effective way of managing this risk. Chains of transactions (where deliveries may have been 'split' or 'partialled' and where the end client may reside in a third country CSD) are extremely difficult to identify and to track when just one CSD is involved, and will be even more difficult in a T2S environment where transaction chains can cross multiple CSDs.

8. **CSDs (as has been agreed for CCPs within the CSDR itself) should be explicitly exempted from Settlement Discipline fines in relation to CSD-CSD links**. For a CSD to be subject to a settlement fine risks the CSD being exposed to (potentially) uncapped liabilities in relation to their own clients, particularly if the participant becomes insolvent. This risk runs counter to the aims of CSDR which is to minimise the risks to which a CSD is exposed.

9. **CSDs generally should not be involved in the buy-in process (as indicated by Article 7(10)(c)), but they should not be excluded from doing so, providing such buy-in services are constructed in close cooperation with the market and with the relevant Competent Authority.** Euroclear agrees with ECSDA and 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.

10. **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. ESMA should avoid putting undue strains on the direct holding models. 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.

General Comments

(i) A flexible regime to enhance competition and market efficiency

We believe that the settlement discipline regime that is designed and applied by ESMA must remain, as far as possible, competitively neutral. The introduction of T2S has encouraged many CSDs to consider providing a single point of access for their existing, and potential clients, to all eligible T2S securities. This requires the development of international asset servicing by those CSDs which, in turn, means that they will compete with, inter alia, other CSDs and local agents. At the same time the two ICSDs provide a highly competitive global securities settlement service (focussed in particular on fixed income markets).

We are concerned that the measures set out in the CSDR to manage settlement fails are limited just to CSDs (e.g. Article 6(2) and (3)) which could lead to a migration of international business away from CSDs and an increase in internalisation of domestic securities on the books of intermediaries, which are not subject to the CSDR.

We recognise that this is a result of the CSDR's institutional and mandatory approach to Settlement Discipline (and Buy Ins), but believe that ESMA needs to show flexibility in its approach in order not to distort the competitive landscape. We recognise that ESMA will consult later this summer on the potential advice it will give to the Commission on the relevant future Delegated Act. However, ESMA must ensure that the scope of the regime and the size of the penalties is appropriate not just to the very low level of fails in Europe, but also to the (increasingly) competitive situation between CSDs and commercial banks.

In addition, we note that no impact assessment has been completed to analyse the effects of applying such a mandatory regime to such a wide range of securities, most of which have never been subject to such a regime. These effects might manifest themselves in reduced liquidity and increased costs for investors.

Therefore, we believe there is a need for a study of the potential effects of a mandatory and detailed settlement discipline and buy-in regime on (i) the wide range of securities required by the CSDR (many of which are not subject to such measures today) and (ii) on the competitive landscape for those CSDs that offer (or plan to offer) a wide range of domestic and international settlement services. In the absence of a detailed impact assessment of the proposed regime, we believe that ESMA should adopt a flexible approach to the specification of the regime.

Finally, another risk of a very prescriptive regime is the lack of flexibility of being able to adjust the regime quickly and effectively to take into account specific market events or evolutions. We cover this point in more detail in our answers to specific Discussion Paper questions below.

(ii) Implementation Timeline

We believe strongly that ESMA needs to phase the implementation of the Settlement Discipline Regime in the CSDR. This is for the following purely practical reasons.

- The implementation of a settlement discipline regime is a highly complex IT project requiring changes to databases, messages and billing mechanisms. In addition, these changes need to be reflected in the systems of our direct clients. To define the business specifications of such a large IT project requires a firm set of requirements, which will be the final Technical Standards and Delegated Acts. These will not be finalised before the middle of 2015. At that point the IT project can begin, running through the standard phases of design (which will require user consultation), build, internal and external testing and trialling and release. The minimum time for the launch of such a project from receipt of the specifications to final launch is 18 months. This would indicate that the very earliest time at which such a regime could go live is the very end of 2016 (ceteris paribus).
- However, from mid-2015 until mid-2017 the EU CSD industry (and its clients) is undertaking the largest IT outsourcing ever seen in the global post-trade industry as settlement services are outsourced to the Eurosystem's T2S service. The scale of this mandatory project, for those CSDs and clients which are participating, is enormous and means that IT road maps are full at least until migration.

Therefore (and 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[3]) 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[4]. A transition period 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, as well as allowing some observations as to settlement efficiency evolves in a T2S environment.

We would welcome more dialogue with ESMA on this subject, but quite simply it is impractical for CSDs to be compliant with the Technical Standards for Articles 6 and 7 as part of the CSDR authorisation process. The process of implementation across Europe will take several years and alternative approaches need to be considered.

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

[4] In addition, CSDs may have to rebuild their record keeping and archiving systems in the same period if the ESMA proposals in relation to Article 29 are implemented (see pages 28-32 of this Consultation response)

Discussion Paper Answers to Questions 1-20

SETTLEMENT DISCIPLINE

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?

Since CSDs are not directly in the scope of article 6(1) on trade confirmation, we do not comment on question 1 of the Discussion Paper.

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. But we do not see how manual intervention can be prohibited, nor do we believe it would be practical or sensible to do so in a legal text.

In most businesses, manual intervention is needed on occasion, in particular where corrective actions are required, or in times of crisis. Restricting manual intervention in regulatory technical standards might create more issues than it solves, 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 insolvencies 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. The hold and release mechanism in T2S could also be termed "manual intervention".

Standard 11 of the ESSF-ECSDA Matching Standards[5] foresees that the instruction process in the CSD should enable the 'amendment' of transactions 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.

[5] 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)

ESMA standards should encourage automation whenever this increases the efficiency and safety of the system. But mandating automation and trying to limit the type of exceptions would be counterproductive and could actually reduce settlement efficiency, removing all flexibility for CSDs and their participants. CSDs should keep full discretion as to when (well-controlled and well-documented) manual intervention procedures are necessary.

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) since article 35 of the Regulation already covers this aspect, and since this would legally freeze the evolution of such standards, requiring amendment to the legally binding technical standards if a message standard needed to evolve to support the development of a competitive financial market.

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

ISO standards do not cover all functionalities and services offered by CSDs. 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 which support an efficient settlement process. Examples (included within the ECSDA response) include messages for static data, certain reports including settlement discipline related reporting, the SBI trade confirmation service in the French market, as well as many of the account level services offered by CSDs in direct holding markets.

We note that Technical Standards for other infrastructures (trading venues and CCPs) do not go to this level of detail and given the arguments presented in the paragraph above, we believe a similar approach should be taken for CSDs.

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

Euroclear 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 a number of explicit exceptions need to be applied to this rule, for instance:

- in the context of corporate actions processing;

- for certain free of payment (FoP) transfers among securities accounts managed by the same CSD participant;
- 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);
- for instructions which are processed as a result of a Court order (e.g. insolvency proceedings).
- 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, or account allocation movements, especially in direct holding markets. Nonetheless, we believe that the phrase "accounts opened in the name of the same participant" should be replaced by "accounts ***managed by*** the same participant" in order to cover all direct holding models.

(b) Continuous matching

Euroclear CSDs already offer real-time matching throughout business day, in line with the ESSF-ECSDA Standard 3. CSDR technical standards should include a general requirement for CSDs to offer matching possibilities throughout the business day, as a means to facilitate early matching and timely settlement.

(c) Standardised matching fields

We are unclear why ESMA believes that matching fields need to be harmonised and standardised in law. Standard 1 of the ESSF-ECSDA matching standards (2006) already contains a list of harmonised matching fields. The compliance rate with all of these ESSF-ECSDA matching Standards has improved steadily over the last three surveys (in 2008, 2010 and 2012). The average compliance rate in September 2013 across all markets was 82%, compared with 74% in 2010. Looking at the 8 major markets, compliance now reaches 91%. These statistics would indicate that there is no market failure in matching which needs to be addressed through legally binding standards. Mandating the use of certain matching fields would, we believe, 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 (where settlement rates across Europe are around 98% of ISD. Fixing such fields in law would also inhibit market development.

(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[6], 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.

[6] 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

Should CSDR technical standards recommend the use of matching tolerance amount to facilitate timely settlement, 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. This flexibility exists in Euroclear Finland (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).

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?

We believe that ESMA should set out in its Technical Standards a tool kit of measures which CSDs could use to incentivise early input of settlement instructions. The tools within this tool kit could include some or all of the measures described in paragraphs 21-34 of the Discussion Paper. Use of the tools within this tool kit should be under the control of the CSD and its Competent Authority depending on the CSDs input and matching statistics.

(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 we understand 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. Euroclear CSDs (FR, SE, UK) have established financial incentives for early matching, or to penalise late 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[7].

Therefore, we believe that 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.

[7] For more details, see http://www.ecsda.eu/uploads/tx_doclibrary/2011_07_07_ECSDA_Fails_Report.pdf

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.

Finally, it should be noted that certain T+0 activities such as lending/borrowing, repo and monetary policy operations, all of which are legitimate market activities, could be penalised by a late input disincentive, which would be counter-productive to smooth market operations.

(b) Hold/release mechanism and bilateral cancellation facilities

Some CSDs already offer a hold/release functionality to their participants, and T2S CSDs 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 a transaction put on hold, but not necessarily to put on hold a transaction already released), often due to a lack of demand by market participants.

The 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 part of the tool kit referenced above if there is a demand from their participants.

As regards bilateral cancellation facilities, the 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").

Bilateral cancellation facilities are best practice, and CSDs should be encouraged (as part of the tool kit) 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

We agree 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 mechanism of how this information needs to be accessed should be specified in Level 2 legislation (e.g. within *x* minutes, and with what kind of message/interface). The practical mechanisms typically depend on the technical design of each CSD's system and on participants' preference based on the costs involved. We agree 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. However, as a minimum standard, ESMA could consider making access to the details of transactions alleged to a participant available to that participant to allow the participant to manage exceptions. 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 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 (as part of the toolkit) for CSDs to allow participants to access the matching status of pending instructions. But, technical standards should not require CSDs to identify and provide information on the causes for unmatched instructions, nor specify the detailed modalities (timing, format) for providing such information.

(d) Other tools to incentivise early settlement

Some CSDs (e.g. FR[8], SE) 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, encouraging the use of automated trade confirmation mechanisms can assist in early matching and early settlement.

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.

We agree with the general analysis provided by ESMA in paragraphs 26 to 29 of the Discussion Paper, but we are 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".*

Such a recommendation would not be a practical concern for Euroclear CSDs. However, in principle, the timing of the batches is equally as important as the number of batches, taking into account time zone differences, and the overall assessment of how optimal settlement efficiency can be achieved should be subject to discussions between the CSDs, other infrastructures, the relevant user committees and the competent authorities, and should not be defined within the technical standards.

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 paragraphs 21- 34 of the Discussion Paper should be part of a toolbox of measures (see above) to facilitate timely settlement; not all tools will be appropriate for all markets at all times. The technical standards should ensure that CSDs are allowed to pick the most appropriate tools (in conjunction with their competent authorities and their participants) to enhance

[8] Although as Euroclear France is joining T2S, the pre-matching facility will be replaced by another tool, the hold-release mechanism.

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, ESMA has produced no evidence as to why mandating the use of technical netting and other optimisation algorithms, partial settlement or trade shaping functionalities, is justified for all CSDs. The shaping of trades is not a function that is offered in TARGET2-Securities, and, if provided at all, can in fact be more efficiently provided at the level of the CCP or trading venue, rather than at CSD level. This appears to go beyond the Level 1 mandate granted to ESMA.

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.

We agree with ESMA that securities lending and borrowing (SLB) facilities should not be mandated in technical standards, but rather should be considered as one possible tool to be used 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 see a market demand for such services. 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 mandate SLB services of CSDs, and no need for technical standards to harmonise such services. SLB services are just another part of the toolkit available to CSDs to use when deemed appropriate.

Monitoring and reporting settlement fails – art.7(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.

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

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?

We understand that the Competent Authorities would prefer that a truly harmonised methodology is used by all EU CSDs for reporting settlement fails to their regulators. However, the costs of such a regime need to be taken into consideration.

Should such a harmonised methodology be required, then it should be based on the existing ECSDA methodology of February 2010[9]. Euroclear has been fully engaged with and fully supports the views of ECSDA in its Discussion Paper response on Q10 and Q11 and does not repeat the argumentation used by ECSDA here.

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 this frequency therefore, appears appropriate, notwithstanding the possibility for authorities to request additional data from the CSD on an ad hoc basis.

Daily reporting might indeed be appropriate in times of crisis, and CSDs should have the ability to generate such reports on a daily basis for this reason. But to require daily reporting appears disproportionate and overly burdensome (including for regulators), 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 on a daily basis could be substantial compared to the benefit such reporting would bring.

Buy-ins – art.7(3) and (4)

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?

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

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

CSDs generally should not be involved in the buy-in process (as indicated by Article 7(10)(c)), but nor should they be excluded from doing so, providing such buy-in services are constructed in close cooperation with the market and with the relevant Competent Authority. Euroclear agrees with ECSDA and 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.

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]". It is unclear how the CSD could monitor and enforce such a rule, if that CSD is not undertaking the buy-in process itself.

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, illiquid securities should be subject to longer timeframes for delivery to the receiving participant.

Suspension of failing participants – art.7(6)

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).

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 sanction in extreme cases and must always be subject to the prior agreement of the relevant Competent Authorities. Any 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 should never automatically trigger the suspension of a participant. Euroclear agrees with the ECSDA proposal that falling below the threshold is simply the ***trigger for further action to be taken to address the situation.***

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

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.

Euroclear, together with ECSDA, has strong reservations about 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"*. We believe that it is the entity responsible for executing the buy-in (e.g. the CCP), rather than the CSD, which needs to be able to link a failed settlement instruction to a given counterparty (trading or clearing member).

Buy-ins of CCP-cleared transactions occur successfully today and the processes used enable CSDs to access the information they need to effect the necessary buy-in. 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 does nothing to ease buy-in execution for CCP cleared transactions.**

Trading venues are typically not participants in CSDs and do 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 4a."* 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(7), particularly given in practice, there is not always a direct correspondence between trading counterparties, clearing members and CSD participants. Imposing a buy-in obligation to trading counterparties in the absence of a CCP thus raises practical problems, such as "who" is responsible for executing a buy-in.

We note that where a CSD receives a transaction feed directly from a trading venue, it is in principle able to link a given trading counterparty and a CSD participant. This allows the CSD to send back to the trading venue the necessary information to manage the buy-in with reference to the trading counterparty, even if it appoints a settlement agent. The CSDR and the revised MiFID therefore, establish a regulatory framework facilitating access to transaction feeds. Such feeds will 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 be specified in these agreements, if applicable at all.

The requirement for a trading member or a clearing member to open a separate account at the CSD per CCP and venue, segregated from other trading or clearing members holding securities with the same CSD participant, would introduce operational complexity into the settlement process. For example, a participant buying securities on exchange A and selling them on exchange B, both of whom would use different CCPs, would require multiple realignments to be undertaken in such a scenario. Even in the instance both exchanges used the same CCP, there would still need to be a realignment to ensure settlement can occur. Such operational complexity would likely increase the risk of settlement failures, and cause more buy-in than would be the case where a participant uses one account for all its activity. Given there is, in practice, not always a direct correspondence between trading counterparties, clearing

members and CSD participants, it is difficult to see how the proposal as it stands would help the buy-in process.

The requirement to open such segregated accounts would anyway 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.

Finally, 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, **CSDR technical standards should not impose segregation requirements on trading and clearing members.**

As noted earlier in this paper, ECSDA has recommended 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.

Late settlement penalties – art.7(2)

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, we expect that the European Commission or ESMA will consult on the delegated act at a later stage. We thus take the opportunity of describing 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 Euroclear and by ECSDA in relation with the Level 2 technical standards on settlement discipline.

The upcoming Commission Delegated Act on penalties for late settlement should:

1. Require that the penalty fee for late settlement be a **fee with a fixed, per trade component** aimed to cover the costs of maintaining the penalty system. Further analysis is needed on whether an ad valorem or fixed fee is appropriate per securities class.
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. **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);
4. **Exempt CSDs in CSD links from the settlement discipline regime**. For a CSD to be subject to a settlement fine risks that the CSD is exposed to (potentially) uncapped liabilities in relation to their own clients, particularly if the participant becomes insolvent. This risk runs counter to the aims of CSDR which is to minimise the risks to which a CSD is exposed.

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 each category.
6. **Allow the calculation method to be adjusted over time** to reflect changing market conditions.

The upcoming Commission 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. A single model might be defined at the level of the T2S platform in the future if the Eurosystem should 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 give CSDs the option of (a) redistributing the penalty monies, after having deducted the part used to cover the CSD's costs of maintaining the system, to the suffering party (although this is a complex regime to build) or (b) retaining the penalties for redistribution to the wider market and/or to projects that benefit the market as a whole.

The argumentation to support some of these suggestions is explained in detail in the ECSDA response to this Discussion paper, and is not repeated here. We strongly encourage ESMA to consider these suggestions when consulting on Article 7(13) and 7(14)(b)). Euroclear will respond in detail to this future consultation (building on the above principles) when the separate consultation is released later this year.

Part 2 Executive Summary

(Questions 21-54 only)

1. **The diversity in CSD business models, activities and size, calls for proportionality in the way in which many technical standards will be implemented.** For example, the CSDR Level 1 text has taken a flexible approach to the definition of CSD services. This flexibility should be upheld in the standards.

2. **For the authorisation process, CSDs and their competent authorities should be allowed to use some of their current supervisory or self-assessments and reporting tools/data flows to avoid duplication.** For example, CSDs may want to use their assessments under the CPSS-IOSCO Principles for financial market infrastructures, and ESCB assessments, including for CSD links.

3. **The recordkeeping requirements currently proposed by ESMA should be revisited, and should not confuse CSDs with "trade repositories". In line with the CSDR text, rules on recordkeeping should allow regulators to assess compliance with the CSDR.** The standards on recordkeeping should therefore, not add elements to the compliance required by CSDR itself (e.g. the list of compulsory recordkeeping items, the introduction of LEIs, direct data feed to competent authorities, etc.). Based on information collected by ECSDA from 18 European CSDs, and assuming that the proposed ESMA requirements would have to be implemented, ECSDA estimates 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 formats for CSD records and reporting, in particular, would be extremely costly to implement.

4. **ESMA should consider an appropriate transition period for standards requiring important technical adaptations to CSDs' systems.** ESMA should 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:

    a. Settlement discipline: See page 6 above;

    b. Recordkeeping: Depending on the scope of the final requirements, an appropriate transition period will have to be determined to allow CSDs to amend existing systems or develop the required functionalities.

Allowing less time for such implementation might mean that CSDs would not be able to submit a complete application file for many years, a situation which would be undesirable as it would lead to uneven application of CSDR across the EU**.**

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

6. **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 (CRDIV and CRR in particular).**

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

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

We agree with the frequency and scope of the reporting.

We believe the reference to "transfer order" should be avoided as it has a meaning specific to the Settlement Finality Directive. The term "settlement instruction" is more appropriate in the frame of settlement internalisation which is settlement taking place outside a securities settlement system.

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

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.

Euroclear agrees with the general "building blocks" contained in Annex 1 of the ESMA Discussion Paper. However, the CSD authorisation process should not be unnecessarily burdensome and costly.

We believe that the information specified by ESMA under article 17(8) and detailed in Annex 1 of the Discussion Paper should not be considered as "minimum requirements". First, the proposed requirements are very detailed and extensive. Secondly, there is a need to ensure a consistent and fair application process for all CSDs across the EU. The contents required of CSD applications should be very similar 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 avoids this term in the technical standards and designs instead a single, harmonised list of elements to be contained in CSDs' application documents.

Given the diversity of CSD business models and service offers, we note that not all the required items listed in Annex I of the Discussion Paper 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.

We also wish to stress that CSDs and their competent authorities should be allowed to leverage the extensive information provided as part of the yearly disclosure or self-assessment reports under the CPSS-IOSCO Principles for financial market infrastructures (PFMI), or regular prudential inspections. Existing assessments and disclosure reports are 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, but also promote consistency. This is in particular 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.

In this context, we note that, while the requirements on CRAs and TRs have been taken as a starting point, these entities were typically not subject to regulatory authorisation requirements prior to the CRA regulation and EMIR and therefore, were starting the authorisation process from a limited amount of existing information given to regulators. CSDs on the other hand are already today highly regulated entities and have submitted significant amounts of information under their current regimes to meet requirements similar to those foreseen by CSDR.

More practically, 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), CSDs and competent authorities should be able to refer to, and rely on, existing link assessments, whenever 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. Finally, we note that some issues included in Annex I of the ESMA Discussion Paper are still subject to discussions within T2S, such as point G6 on the moment of entry and irrevocability of transfer orders. We thus encourage ESMA and national competent authorities to take these discussions into account in relation to the CSDR authorisation process.

The application process should allow for transitional measures on some standards. 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". In this respect, we stress that the standards related to settlement discipline (as indicated in our response to questions 1-20) as well as those on recordkeeping (see answers to questions 28/29 below) will require substantial developments in CSDs' systems. Making the application for CSD authorisation dependent on the compliance with all ESMA standards may therefore mean many CSDs may not be able to submit a complete application file for several years. We cannot believe this would be a sound situation, as CSD authorisation across the EU would be uneven and could take several years, with a resulting unlevel playing field as a consequence. It seems therefore, preferable for ESMA to agree on a transition period for these standards or the ability to authorise a CSD based on an action plan to become compliant within a reasonable time frame.

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 believe the CSD and its Competent Authority ('CA') should have the flexibility to decide on the practical organisation of documentation exchange and reference numbering. They should build on existing processes or reporting mechanisms. For example, we believe it should be the CA that should keep the reference numbering taking into account the documents already has in its possession. Else, in case a new document or an updated one needs to be provided to the CA as it would lead each time to an unnecessary but cumbersome update of the list of the documents.

As an additional argument in favour of some flexibility, CSDs that have a banking licence are subject to a different communication and reporting mechanism with their CA, typically imposed by the CA under the relevant banking legislation. Their application for the CSD authorisation may therefore re-use some of the elements of the banking authoritisation.

Conditions for CSD participations in other entities - Article 18

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?

Euroclear CSDs currently have a number of participations other than in CCPs. Our CSDs have a number of subsidiaries which are used for cash/client/asset protection and segregation reasons. It is common practice to use nominee companies for the purpose of asset protection. For example, EUI owns nominee 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 CSDs' services in a safe and efficient way. The CSD takes full 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).

We believe that the restrictions suggested by ESMA are unnecessarily rigid and risk putting too many brakes on the evolution of the CSDs. We absolutely recognise the need for technical standards to ensure that participations in other businesses do not put the CSD activities at risk. However, some of the proposed restrictions are not justified and could actually prevent CSDs from strengthening and diversifying their market infrastructure activities, which in fact contribute to reduce 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, and one way of developing such solutions is for a CSD to establish subsidiaries or to have participations in complementary businesses. Preventing CSDs from holding participations in new business ventures could in such cases hamper market development.

In addition, the CSD's recovery and resolution arrangements should specifically address the risks involved in any CSD participations.

More specific comments:

1. Guarantees (§92-93)

We do not recommend that ESMA introduce the proposed restrictions on guarantees. In some instances, this would simply prevent CSDs from conducting their business. For example, CSDs are obliged to use nominee companies for purposes of asset protection (cash or securities) or may decide to offer certain services directly out of a subsidiary. The CSD must be able to take full responsibility for such entities vis-à-vis its participants. Any limitation on the CSD's liability will typically result from the terms and conditions applicable to the service and should be subject to the general capital requirements in CSDR.

2. On limiting control (§94-95)

§94 and 95 seem to be mixing an internal governance and (legal) risk issue with the question of participation. We agree that the issue of a parent company being held responsible for certain actions or losses in its subsidiary is important, but would expect this issue to be addressed by the CA as part of its assessment of the governance and legal structure in the CSD (of which the subsidiary is only a part).

Moreover, the proposed prohibition for CSDs to hold participations where they assume control unless covered by liquid capital is problematic. First, it is not clear how such a requirement could be implemented in practice. Secondly, assuming control of an entity in which it participates can be a way for the CSD to better manage the risks resulting from that participation. A CSD should be allowed to exercise effective control over subsidiaries when their CA is confident that the risks resulting from the activities of the subsidiary are properly managed.

3. On limiting revenues generated by CSD participations to a certain percentage of total revenues (§96):

We find this criterion artificial and do not believe this element should form part of the technical standards for the following reasons:

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

- A nominal threshold would be cumbersome to implement, especially given the uncertainty about annual revenues. In practice, a CSD's revenues might differ from its initial forecasts; revenues from its participations might unexpectedly exceed any threshold. This would then require the disposal of its participation, possibly at a loss, when the extra revenues are actually contributing to 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. Forcing a CSD to be able to finance itself solely from its core business also seems odd; diversification may be more valuable as a risk mitigating measure.

- 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. 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, in contradiction with the objective of CSDR.

- The CSDs and their CAs are already discussing recovery and resolution plans which address the topic of participations. In this context, for resolvability reasons, keeping certain activities in separate entities but fully owned by CSDs would seem prudent.

4. On limiting participations to other entities in the securities chain (trading venue, CCP, trade repository) (§97)

We are not in agreement with ESMA's proposal to limit CSD participations to other entities in the securities chain. Indeed, **a CSD can have very legitimate reasons to hold participations in other types of entities which are not directly part of the securities chain, but still offer complementary or supporting services to the CSD's activities, such as IT companies or financial information providers/data vendors.** We therefore 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 or supporting services to their CSDR-authorised activities.

We can only agree with ESMA that a CSD could have a participation in a CCP *if* the CCP's recovery and resolution would not endanger the survival of the CSD.

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. Requiring competent authorities to ensure that the activities of the entities in which a CSD holds participations are complementary to, or supportive of, the activities of the CSD;
2. 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;
3. 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
4. CSD recovery and resolution arrangements will need to take into account the risks related to CSD participations.

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

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 Euroclear CSDs mostly already provide the information listed in §105 today.

The annual review of CSD's compliance with CSDR should rely as much as possible on information already provided by the CSD. It should only require CSDs to provide information where such information is not yet available to the Competent Authorities. For example, CSDs should not be required to prepare extensive additional reports summarising information that was already sent to the competent authorities through a different channel.

The annual review exercise should also leverage as much as possible the CSDs' assessments against CPSS-IOSCO PFMIs, or CA inspections, which cover most of the information required for the review. In addition, CSDs should be allowed to use their ISAE3402 and Internal Control System (ICS) reporting.

Recognition of third country CSDs - Article 25

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.

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 to ensure ongoing supervisory equivalence just like for EU CSDs.

We also wish to highlight that ESMA should consider reciprocity in market access. It is well known that the EU policy of increasing competition between CSDs it not supported in many non-EU countries which favour monopoly provision of CSD services. ESMA should not allow a third country CSD to compete in the EU if EU CSDs cannot enter that third country's CSD market.

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

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?

We believe the proposal made by ESMA in §110 - which would require CSDs to monitor, not only their own risks, but also to the risks they pose to participants and other entities – 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.**

Conflicts of interest

We generally agree with ESMA's proposal on conflicts of interest but some clarifications are required as regards the examples listed in §116. 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. **The focus should be, rather, 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".*

In case of user-owned, user-governed CSDs, conflicts of interests between users and CSDs are a natural consequence of the governance model. We hence 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.

Regular and independent audits

We provide the following comments related to §120:

- 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 assume that the Level 1 text is referring to statutory audits (referred to under § 118), and not to internal audits (referred to under § 120). Indeed, unlike statutory audits, internal audits are likely to contain non-public information on detailed risk management processes and procedures which are not meant to be disclosed outside the CSD. For example, it is conceivable that such audits could contain information on the risks posed by 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.

- Question 27 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*". For example, findings related to a major IT outage, severe delays in settlement processing, etc. may be topics to share with the user committee.

- §120 also states that "*independent audits should be performed at least on an annual basis*". This could be interpreted as a requirement to audit all activities every year, whereas the International Internal Audit Standards state that Internal Audit should establish a risk-based plan to determine the priorities of the internal audit activity.

- 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.

Recordkeeping - Article 29 (3), (4)

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?

We believe the recordkeeping proposals are excessive and not always in line with the CSDR itself. We urge ESMA to review its approach to make it more coherent with CSDR and more practical to implement. We have several concerns related to the proposed minimum requirements on recordkeeping:

- **The objective of recordkeeping as stated in Art 29 is to ensure the NCA can verify compliance with CSDR.** We believe the proposed recordkeeping standards should solely focus on

the CSDs' requirements under CSDR and not add requirements to those in CSDR. For example the intention of recordkeeping should not be to give CSDs a role that is similar to Trade Repositories or CCPs (that have been given a clear role in EMIR to report transactional data to regulators). CSDR does not include such a role for CSDs. For CSDs, CSDR recordkeeping is about data retention and archiving in order to reply to NCA inquiries. Also, there is no rule in CSDR that requires CSDs to offer a direct data feed for transaction data to NCAs (as suggested in §133). We offer proposals for adapting the ESMA text in Annex 1 to this response.

- **The list of required data as included in Annex III of the Discussion Paper - even when related to core services - should be flexible** as data fields available in a CSD depend on its service offering and data required for its operational processes. In CSDR, the possible services offered by CSDs are included in the sections A, B and C of the Annex. As per CSDR art 2 and 16, there is flexibility in the CSD service offering which will be defined in the CSD authorisation. The ESMA standards on recordkeeping should therefore be coherent with this flexible approach and leave room for the Competent Authority ('CA') and the CSD to agree on required data retention. Our comments on Annex III are included in Annex 2 to this response. Some of the ESMA proposed required records are currently not captured by CSDs; requiring the collection and maintenance of such data not only represents a cost to the CSDs, but also to their customers (a cost which is not yet included in the below cost estimate).

- We agree with ESMA's statement in §129 that the costs for maintaining the records vary very much as a function of how records are maintained (i.e. online or off-line). **The proposed technical requirements of recordkeeping (on-line inquiry possibility, possibility to re-establish operational processing, query through numerous search keys, ability to retrieve records maintained offline within a few days at most) are much more demanding than current CSD recordkeeping practices.** Such investment (see ECSDA's cost estimate below) can be warranted only if the standards would be in response to severe weaknesses in current CSD recordkeeping practices, a weakness which, to our knowledge, has never been identified by our CAs, the European Commission or ESMA. Therefore, we believe ESMA should revisit these technical requirements to make them more commensurate with the actual objectives and needs of CAs.

- For CSDs participating in T2S in particular, having to replicate records 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 believe therefore that the requirements being proposed by ESMA are disproportionate, and go beyond what is required for effective supervision.

- For CSDs with a banking licence, existing prudential reporting requirements, tools and channels could be reused.

- 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 relevant data related to core and ancillary services only and that it can be demonstrated by a process-based assurance (e.g. based on access management rules and on

internal due diligence on the adequacy of such rules). For records not linked to core and ancillary services, it should be possible for the CSD to make changes, albeit with a strictly controlled and tracked record of the amendments made.

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 many 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 timing and resource constraint and determine an appropriate transition period to allow CSDs to develop the required functionalities.

ECSDA 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 translates 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 number of times to implement these requirements, and would face a considerable challenge in mobilising the required human resources.

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

The technical standards should not require CSDs to build and maintain direct data feeds for their competent authorities. Such a measure seems to exceed the mandate granted to ESMA under the Level 1 Regulation. In addition to the cost considerations, detailed discussions would need to take place between regulators and CSDs to confirm whether and how they would make use of such data feeds. It is far from certain that new data exchanges would present significant advantages compared to CSDs existing data feeds which are already efficient and acceptable to the CAs.

Use of LEIs

§132 suggests that ESMA could request standardised data including the use of LEIs. This proposal goes beyond the level 1 ESMA mandate on recordkeeping. **CSDR does not mandate CSDs to harmonise data records or to introduce LEIs**. Imposing data record harmonisation or the use of LEIs for the purpose of recordkeeping is very costly for CSDs to implement and unlikely to bring any substantial benefits.

In addition, the scope of a requirement to use LEI´s would need to be carefully considered. For example, if the requirement were to include account holders/clients/owners at the CSD it would (in the direct holding markets) encompass several hundred thousand companies. Beyond the significant administrative costs this would mean for the concerned companies, it would also seem to counter to the stated principle that CSDR should be neutral in relation to the different holding models in Europe. The same reasoning would mostly apply if the requirement were to include issuers, most of which do not use LEI today.

We do not deny the potential benefits linked to the use of LEIs, but we believe that CSDR technical standards on recordkeeping are not the right place to mandate the use of LEIs. More analysis is needed, and a gradual implementation of LEIs outside derivatives markets should be coordinated at global level, rather than imposed on EU CSDs only via binding regulation.

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

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 on 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, but they should not be considered as a binding or exhaustive list and should not be**

included in the technical standards.

On the examples related to legal risks,

- On 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"*, but rather they **should be allowed to rely on the existing regulatory 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,
- The fifth example should also refer to insolvency rules and rules of public order in the country of the CSD. Indeed, the Settlement Finality Directive ('SFD') protections from which a CSD benefit also depend on the implementation of the SFD in the CSD's own jurisdiction. We note however, that a crisis prevention measure or a crisis management measure under the BRRD may not be recognised as insolvency proceeding under SFD and might not result in mandatory suspension of a participant.

On the examples related to operational risk,

- The first example should be re-phrased to "that it can comply with the current rules and procedures of the CSD". The wording referring to the risk management rules of the CSD is too narrow. The rules of the CSD contain a number of requirements such as the obligation to appoint a cash agent (which are indispensable for the proper functioning of a settlement system) but which strictly speaking may not be viewed as risk management requirements.

Furthermore, as per § 135, it is important to keep in mind that the "risk analysis" mentioned in Article 33(3) of the CSDs is only required in cases of refusal. This means that CSDR Technical Standards should not make the procedure followed by CSDs when approving a new participant stricter. 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 cases where the CSD has doubts on the eligibility of an applicant-participant.**

We would appreciate clarification in the technical standards that - should an applicant fail on one of the risk grounds (e.g. on AML grounds) - the CSD should not be forced to make an extensive risk assessment on the other elements of the application.

We would also request ESMA to ensure that the future CSDR Technical Standards do not prevent corporates (i.e. non-financial institutions) from being accepted as CSD participants, when applicable (for

example corporates making use of CSD services in the repo market).

Finally, we note that currently some specific participation criteria are determined directly or indirectly by national law, often with a link to the Settlement Finality Directive. Spanish provisions also disallow companies from other Member States to become direct CSD participants. In other countries, the CSD's CA has to confirm its approval of new CSD participants. As a result, it will be important to avoid contradictions between CSDR Technical Standards and existing national rules on CSD participation. We assume that the current national rules will need to be adapted in line with CSDR and the new Technical Standards. We also note that a central bank could refuse to provide a cash account to a participant in which case the CSD may not be able to accept the client either.

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. As noted above, CSDs may allow non-regulated firms such as corporates as participants in which case parts of the refusal process will not be relevant as an unregulated firm would not have the possibility to refer the matter to its CA.

Integrity of the issue - Article 37

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.

To our knowledge, no weaknesses have been identified that would require such a standard to be mandatory across all EU CSDs.

We note that reconciliation requirements for CSD links are not covered under this technical standard but rather under the standards related to CSDR Article 48§6. This may need to be clarified by ESMA.

As regards §144, we do not understand ESMA's reasoning. Preventing settlements in case of a reconciliation issue is a measure that entails important risks for market participants and the CSD. For example, blocking settlement for the totality of transactions in a Eurostoxx 50 share because of a reconciliation problem on 5 shares is clearly disproportionate.

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.

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

Yes, 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.

Operational risks - Article 45

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

We would suggest adding the following: "*operational risk is the risk that deficiencies in information systems, internal processes, and personnel or disruptions from external events will result in the reduction, deterioration or breakdown of services provided by an FMI or in a loss*".

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 PMFI. We would like to make the following suggestions for amendment:

Paragraph in the ESMA Discussion Paper	Clarifications required
§160: The CSD *"should also have comprehensive and well-documented procedures in place to […] resolve all operational incidents"*	Euroclear suggests 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.

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?

In §166 (page 53 second bullet point) we request ESMA to include the following: "The CSD should provide – ***where practical*** - for procedures for the introduction of new technology including clear reversion plans".

We do not agree with the ESMA proposal, in §167, 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 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 resources, capabilities, functionalities and staffing arrangements of the secondary processing site and a geographic risk profile distinct from that of the primary site?

We agree with ESMA recommendations that CSDs should set up a BCP infrastructure to address a regional disaster event.

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.

Investment policy - Article 46

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 can agree with the proposed approach. We would like to stress however, that unlike CCPs, CSDs do not use their capital to guarantee clearing or manage credit risk in the market, and that rules on their investment policy should therefore, not necessarily be as strict or detailed. In practice, CSDs typically have a limited amount of capital to invest and generally keep that capital in cash deposits. Likewise, concentration limits might not be necessary for a CSD that typically has a capital of EUR 5 to 20 million.

We do not understand the rationale behind the ESMA statement in §182, 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, in order to mitigate risk. This is certainly needed for CSDs with a banking licence. We do not consider the use of the instruments for hedging as "investments".

A distinction between CSDs 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 capital requirements of CSDs, additional rules would not seem proportionate. As noted above, for CSDs with a banking licence that have a more extensive capital base, the rules in CSDR article 59 should prevail.

CSD links - Article 48(10)

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.

We support 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 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. The cost of this due diligence would have to be multiplied, for each CSD, by the number of its links, and would add to the already significant compliance costs CSDs will be facing to comply with other parts of CSDR, whilst also being under pressure to increase their number of links with the arrival of T2S. In our assessment, the potential extra cost of this "extensive" analysis would be a yearly cost of €200 000 plus a €5000/10000 cost for a legal opinion per link. We recognise, however, that a more detailed analysis will usually be required for links with non-ESMA recognised third country CSDs (although CSDs may use the third country CSD's CPSS/IOSCO or IMF assessment(s) in the frame of the FSAP as part of this analysis).

The Technical Standards should take into account existing CSD link assessments, as performed under the Eurosystem framework or under the CPSS/IOSCO PFMI to avoid unnecessary duplication and cost.

In §190, with regard to the bullet point that includes "*measures have been taken to ensure segregation, both on an omnibus and individual basis…*", we believe the text is not coherent with CSDR art 38 which does not impose either model of segregation. We therefore propose the text to say "*measures have been taken to ensure segregation in line with CSDR article 38 ~~, both on an omnibus and individual basis…~~".*

ESMA's reflections in §191 on DVP links seem to be partially overlap with the standards required under art 48§7 on DVP settlement (question 46).

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 with the ESMA proposed procedures.

However, as indirect links are currently not formally subject to such procedures, we recommend 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 the EU 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 the ESMA proposal.

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.

We broadly agree with description in §199 of the cases where DvP settlement can be considered practical and feasible.

In §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 across the link to be possible (at least when both CSDs are not in the same currency zone). This would mean DVP settlement in links is often only possible in commercial bank money. 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).

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

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.

While CSDR refers to the CSD's refusal of an issuer, the case where the CSD refuses a certain issuance from an issuer is also relevant. For example, the CSD may accept to offer notary services to an issuer for its fixed income securities, but not for its equities (e.g. as the latter requires more specific service set-up for the CSD, such as a potential link with a CCP or trading venue, specific withholding tax procedures). ESMA may wish to reflect the refusal of "issuance" in its standards as well, as we believe such case is as relevant in practice.

We agree with ESMA's proposal as regards the type of risks that need to be taken into consideration 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 the list should

not as such be included in the technical standards. **It should also be clear that CSDs <u>can</u>, but do not have to, refuse issuers on these grounds. It is important that ESMA also recognises that the absence of a feed from the relevant CCP or trading venue to the CSD may be a reason for refusing a securities issue.**

In §206 on legal risks, we would suggest adding: "the issuer, in the reasonable opinion of the CSD, does not comply with the CSD's rules and requirements".

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.

Yes, we agree with the ESMA proposal.

<u>Refusal of access for CSD links - Article 52(3), (4)</u>

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.

We believe the last bullet point of §216 should be amended as follows:
"*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. <u>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</u>.*"

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?

We believe an access refusal for T2S links is very unlikely as T2S links will be between CSDs authorised under CSDR.

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

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?

The CSDR refers to access from other market infrastructures to CSDs as well as access from CSDs to other market infrastructures. The ESMA standards only relate to the refusal of access of the CSD to other market infrastructures, but not the other way around. This means there will be a gap in the regulatory treatment of access between CSDs, CCPs and trading venues.

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.

Some more detailed comments:

§218 - Legal risk: even if the requesting market infrastructure is a regulated entity and its framework may be comparable to that of the CSD, it may not have the regulated status required by the CSD. For example, in order to ensure adequate insolvency protection of transfer orders in the settlement system, the CSD must be able to require that the infrastructure falls within the scope of the CSD's local Settlement Finality Legislation. This should be covered in the second indent by adding "or required by the CSD's rules and procedures" or by replicating the insolvency risk criterion listed under participation requirements.

§ 218 - Operational risk: Access by another market infrastructure to a CSD generally involves a set of customised bilateral arrangements to be put in place. Such developments can put strains on the CSDs IT and operational prioritisation. Therefore, even if the requesting infrastructure were willing to pay for certain customised developments, a CSD may not be able to find the necessary internal or external expertise to meet the request within a reasonable deadline without putting other critical projects at risk. We believe refusal on such grounds would be permitted under the criterion listed in the fifth indent of operational risk, but request that you clarify the point in the final standards.

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 broadly agree with the ESMA proposal, but believe the three months mentioned in the last bullet point of §223 may be insufficient for the CSD to provide access as such access may entail IT and other investments the secure and efficient roll-out may not be possible in such short time frame.

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

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

Yes, we agree with the ESMA proposal.

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" is relevant information as the credit institution will be subject to the CSDR articles 54 and 59, and to the limitations included in Section C of the CSDR Annex.

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:

- Ensuring 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)
- Recovery and resolution arrangements of the two or more legal entities should be aligned
- Possible conflicts of interest in the governance arrangements of the respective entities should be addressed.

Annex 1 – Proposed amendments to ESMA text on recordkeeping

Recordkeeping (Article 29(3) and (4))

122. ESMA considers that the key elements to draft technical standards on CSD record keeping should require **CSDs to demonstrate compliance with the CSDR and to provide the competent authorities with requested information in a reasonable time frame. The time frame of retrieval will be discussed with the national competent authority (NCA) and on the type of information requested**. ~~(e.g. a couple of days) to ensure that their records include all information necessary to conduct a comprehensive and accurate reconstruction of the operational process. These should also enable records to be searchable by the following fields at least, forming a set of so-called "master data":~~

~~- link;~~
~~- account;~~
~~- participant;~~
~~- financial instrument;~~
~~- currency;~~
~~- issuer;~~
~~- settlement instruction.~~

~~A process of linkage should be used in order to associate different records that correspond to the same participant, for instance.~~

123. ~~A list of minimum requirements is contained in Annex III and~~ ESMA ~~is~~ therefore consider**s** ~~ing the keeping of~~ the following categories of records could be considered necessary for CSDs to demonstrate compliance with CSDR:

- **operational records such as** stock (e.g. issuers, accounts, securities ID) and flow data ~~flow~~ **(e.g. moment of entry; trade date; currency; …);**
- business (e.g. **contracts, service descriptions, fee documentation, etc.** ~~types of services offered; penalties; …~~); and
- governance and policy (e.g. organisational charts; minutes of meetings; …).

The records to be kept by the CSD will mainly depend on:

1. **The services described in CSDR Annex Sections A (core), B (ancillary) and C (banking ancillary) for which the CSD has received authorisation from its competent authorities, and**
2. **The data the CSD requires to perform the operational processing linked to these services.**

Actual data records (for core and ancillary services) to be maintained should be discussed with the NCA in the frame of the CSD authorisation file and should focus on those records that demonstrate compliance with CSDR.

124. This grouping was considered having in mind the current available data in CSDs and the CSDR requirements:

- the CSDR approach is to enumerate the services (Annexes A to C) in order to define what legal person qualifies as a CSD and these services give rise to a diversified set of data;
- some data is of a more quantitative and operational nature and relates to the business actually performed - part of this data was therefore sub-categorised by using a stock versus flow approach;
- the transaction data was subclassified in ”stock”, ”flow” and ”other/business” categories in order to take into consideration the data related to the operations actually performed and the data of a more static or descriptive nature reflecting the type of services offered and the different categories of potential actors and financial instruments involved such as issuers, participants and the instruments issued, maintained or settled;
- on the business data this is usually already at the CSD’s immediate and permanent disposal.

125. On ancillary services a functional approach could be considered. This means that depending on each of the specific ancillary service provided, the CSD will need to keep the records as appropriate from the CSD perspective. Under this approach and differently from the one described under the core services, there is no specific list of documents to be kept. This is to allow the necessary flexibility in the performance of non-core services.

126. The section Ancillary services (AS) under Annex III covers most of ancillary services provided, irrespective of the banking or non-banking nature of the CSD. The recording of each of the individual elements under section AS depends on each of the services rendered, as applicable to each CSD specific case.

127. As for governance and policy records, ESMA considers that CSDs should maintain adequate and orderly records of activities related to its internal organisation and business policy. Those records should be made or updated each time a material change in the relevant documents occurs.

Data keeping and availability / other aspects

128. ESMA also considers that:

- ~~based on the seven main elements enumerated as master data above, ESMA considers that the content of CSD records should concretely and, at least, include all items detailed in Annex III to this DP.ESMA understands that~~ most of these records are already part of the current CSD’s record set or that they correspond, at least, to current CSDs activities and elements.

- the records should be retained in a medium that allows the storage of information in a format ~~accessible for future reference by the competent authorities, and in such a form and manner that the following conditions are met: i)~~**that makes** it possible for **the CSD to provide** the competent authorities **with requested information in a reasonable time frame. The time frame of retrieval will be discussed with the NCA depending on the type of information requested.** ~~(e.g. a couple of business days) to access the records readily and to reconstitute each key stage of the processing involved~~;
- **CSDs should ensure that** ~~ii)~~ it is possible **for them** to record, trace and retrieve the original content of a record before any corrections or other amendments; and ~~iii)~~**they have internal policies in place that should ensure** it is not possible for **transaction data** records to be manipulated or altered;
- all records required to be kept by CSDs should be open to inspection by the competent authority - the CSD should name the relevant person or persons that can, without delay, explain the content of the records maintained;

~~at a first stage, a list approach of records to be kept should be followed for the drafting of the standard on transaction and governance and policy records, given the input by the industry - nevertheless, these two lists of data to be kept will not be exhaustive lists, in order to allow for specific requests by the competent authorities in future. In this respect, these lists should be considered minimum requirements for all CSDs and the competent authority at their own discretion may demand further records to be kept by the CSD, keeping in mind the principles of proportionality.~~

129. ESMA is aware that the costs for maintaining the records vary very much as a function of how the records are maintained, i.e. whether they should be maintained online (immediately available) or if they can be maintained offline ~~(i.e. they can be retrieved within few days delay).~~**To demonstrate compliance with CSDR, ESMA considers appropriate that records can be maintained offline and can be retrieved upon request within a reasonable timeframe.**

130. CSDR requires that all records are maintained for at least ten years.. ~~However, CSDR does not specify the modality according to which they can be stored. ESMA could, therefore, consider to differentiate in the ITS the modality according to which these records should be maintained. This would be particularly relevant for transaction records.~~

131. ESMA considers that if the CSD maintains the relevant records outside of the Union, no legal or technical impediment should occur to the ~~prompt~~ access to this data. Competent authority should be able to access this data with the same modality and delay as if they were maintained within the Union, notably as regards data protection and privacy rules.

132. As regards format in particular, **CSDR does not mandate harmonisation.** ESMA **nevertheless considers it very valuable for CSDs to use** ~~may consider~~ a number of standard, open, non-proprietary standards. These may include the LEI for legal entities and a client code for the identification of

individuals. This is compatible with EMIR and the international trend for the use of LEI in financial infrastructures (CCPs, TRs and financial and non-financial counterparties to derivatives under EMIR for instance). The BIC has been used in CSDs, and the cost of change may be significant. It must be noted, however, that there would also be a cost for regulators and the industry not to use standardised codes and have different codes (e.g. BIC and LEI) for different infrastructures (e.g. CCPs and CSDs and probably many issuers and brokers). ESMA is **therefore considering encouraging CSDs to gradually** implement the LEI as the code for identifying legal entities, **thereby also taking into account the specific challenge this poses to direct holding markets which have hundreds of thousands of companies as participants** ~~under CSDR.~~

~~133. Finally, ESMA might also consider requiring that for transaction records a direct data feed to the competent authority could be envisaged, when requested by the latter.~~

Annex 2 - Proposals related to Annex III of ESMA discussion document

CS	In relation to core services				
SR	**Stock records**	**Data to be kept**	**Data not kept in CSDs**	**Relevance of data dependent on CSD service offering**	**Other comments**
1	Issuers			X	Only relevant for CSDs acting as issuer CSDs and that have direct relationschip with issuer Not relevant for EUI, not relevant for Euroclear Bank for issues registered at Common Deps, etc
2	Country of establishment of Issuers			X	Same as 1
3	Persons exercising control on Issuers		X		
4	Country of establishment of persons exercising control on issuers		X		
5	Issuers' 'securities' accounts			X	Issuers seldom hold accounts in CSDs
6	Settlement banks used by Issuers			X	Same as 1+ issuer appoints issuer agent rather than settlement bank
7	Cash accounts used by Issuers			X	Same as 1 + issuer appoints issuer agent – CSD generally has no view on this
8	Securities initially recorded in the CSD			X	Same as 1 – only available if CSD provides this service
9	Securities maintained by the CSD	X			
10	Characteristics of the securities initially recorded in or maintained by the CSD			X	Same as 1 – only available if CSD provides this service
11	Participants	X			
12	Country of establishment of Participants	X			Country of residence
13	Persons exercising control on Participants			X	Such information is possibly available in KYC files but not in standard operational databases and is not relevant to a CSD
14	Country of establishment of persons exercising control on Participants		X		Generally not available in CSDs
15	Participants' securities accounts	X			
16	Settlement banks used by Participants			X	Not relevant for Euroclear Bank as it settles in commercial bank money
17	Cash accounts used by Participants	X			
18	Issuers' 'securities' accounts - end of day balances			X	Same as 1
19	Participants securities accounts - end of day balances	X			
20	Participants cash accounts - end of day balances	X			

FR	Flow records				
1	Delivering participant	X			
2	Delivering participant settlement instruction (delivering instruction)	X			
3	Client of the delivering participant, where applicable			X	Information mostly not required by/available in CSD
4	Delivering participant securities account	X			
5	Delivering participant's settlement bank			X	Information not required by/available in most CSDs
6	Delivering participant cash account	X			Definition of cash account might be needed.
7	Receiving participant	X			
8	Receiving participant settlement instruction (receiving instruction)	X			
9	Client of the receiving participant, where applicable			X	Information mostly not required by/available in CSD, nor relevant
10	Receiving participant securities account	X			
11	Receiving participant's settlement bank			X	Information not required by/available in most CSDs
12	Receiving participant cash account	X			
13	Moment of entry timestamp of the delivering instruction	X			
14	Moment of entry timestamp of the receiving instruction	X			
15	Moment of irrevocability timestamp of the delivering instruction		X		This information is not always covered by a timestamp but also by contractual rules. This comment also applies to 16, 17 and 18 below
16	Moment of irrevocability timestamp of the receiving instruction		X		
17	End of validity date of the delivering instruction, where applicable		X		
18	End of validity date of the receiving instruction, where applicable		X		
19	Matching timestamp, where applicable	X			
20	Trade date	X			
21	Intended settlement date	X			
22	Securities object of the settlement instructions	X			
23	Currency	X			
24	Settlement amount	X			
25	Quantity/nominal amount	X			
26	Settlement: Yes/No			X	This is a specific transaction status rather than a separate field
27	Settlement timestamp	X			
28	Settlement agent of the cash leg				Unclear to what this refers (settlement agent or settlement bank?)

29	System generated delivering instructions (in case of partial delivery, shaping)			X	Only when CSD offers this
30	System generated receiving instructions (in case of partial delivery, shaping)			X	Only when CSD offers this
31	Buy-in: Yes/No				Information not currently available at CSD level
BRO	**Business/other records**				
1	Issuers' and Participants' details, including authorised signatures			X	Some CSDs do not ask for list of signatures from Participants or Issuers but rely on trade register information. Not all CSDs have an issuer relationship
2	Settlement agents for the cash legs			X	Unclear to what this refers
3	Types of services offered	X			
4	Categories of Issuers accepted			X	Can also be categories of securities accepted
5	Categories of securities initially recorded or maintained	X			
6	Categories of Participants accepted	X			
7	Types of securities' accounts offered	X			
8	Volumes and values of settlement fails	X			
9	Penalties	X			
10	Major incidents in relation to core services (including summaries of incidents and of remedial actions)	X			
GP	**In relation to governance and policy records**				
1	Organisational charts for the management body and relevant committees, operational units, risk management unit and all other relevant units or divisions	X			
2	Identities of the shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings and the amounts of those holdings	X			
3	CSD participations in other legal entities	X			
4	Documents attesting the policies, procedures and processes required under the relevant organisational requirements	X			
5	Minutes of management body meetings and, if applicable, of meetings of sub-committees of the management body and of senior management committees	X			
6	Minutes of meetings of the user committee	X			
7	Minutes of consultation groups with participants and clients, if any			X	Depends to which groups this refers

8	Internal and external audit, risk management, compliance reports, and reports by consultant companies, including management responses	X except for consultancy reports			
9	Major outsourcing contracts	X			
10	Business continuity policy and disaster recovery plan	X			
11	Complaints received, with information on the complainant's name, address, and account number; the date the complaint was received; the name of all persons identified in the complaint; a description of the nature of the complaint; the disposition of the complaint, and the date the complaint was resolved	X			
12	Records of the results of the back and stress tests performed for the CSDs providing banking type of ancillary services	X			
13	Written communications with competent authorities, ESMA and relevant authorities	X			
14	Legal opinions received in accordance with provisions on organisational requirements	X			
15	Where applicable, legal documentation regarding link arrangements	X			
16	The most complete documents describing the development of new business initiatives	X			
17	Tariffs and fines that the CSD has in place	X			
AS	**Ancillary services**				
					General comment: it does not really make sense to list all possible ancillary services in the ESMA standards; CSDs will have their own description/definition of their services which may not correspond to the CSDR language. Recordkeeping should be discussed with NCA in all cases.
1	allocation and management of ISIN codes and similar codes (e.g. issuer/requesting party identification, securities type, securities characteristics, notional amount)			X	
2	asset servicing (e.g. ISIN, type of corporate action, amount of securities/cash, relevant dates for the processing of the corporate action, outcome of the corporate action, information flows, General Meetings related operational processes, tax reclaims, portfolio valuation)			X	

3	cash accounts provided by the CSD (e.g. LEI of participant/investor using the cash accounts, credit limits, currency, deposits amounts)			X	
4	collateral management services provided by the CSD (e.g. as agent for its participants) (e.g. ISIN, amount of securities, identification of delivering/receiving parties, collateral use, collateral valuation)			X	
5	data and statistics services to market/census bureaus (e.g. entities served; data provided; purpose)			X	
6	general collateral management services as agent (e.g. entities served; purpose; value details)			X	
7	banking type of ancillary services provided by the CSD including (e.g. incidents in relation to that such service and remediating actions including follow-up, details such as cash account, type of operation, purpose of operation, beneficiary)			X	
8	IT services provided (e.g. details on nature of services and how different from the core IT services)			X	
9	operations in relation to cash accounts (e.g. type; purpose;)			X	
10	order routing and processing, fee collection and processing and related reporting (e.g. types of orders, types of fees, purposes of fee collection/processing, involved parties)			X	
11	regulatory reporting services (e.g. under which regulation; nature of service)			X	
12	securities lending operations performed by the CSD as principal or as agent for its participants (e.g. ISIN, amount of securities, identification of delivering/receiving parties, purpose of the securities lending operation, characteristics of collateral, collateral valuation)			X	
13	services related to shareholders' registers (e.g. ISIN, relevant entities involved in the process, information flows)			X	
14	settlement matching, order routing, trade confirmation, trade verification operations			X	
15	the links established by the CSD			X	