

**ESMA's Discussion Paper
on Draft Technical Standards for the Regulation
on improving securities settlement
in the European Union
and on central securities depositories (CSD)**
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AMAFI's response

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI has more than 120 members operating for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives. Nearly one-third of its members are subsidiaries or branches of non-French institutions.

The Association has been following closely the preparation of the Regulation on improving securities settlement in the European Union and on central securities depositories (CSDR) and welcomes the opportunity to answer ESMA's consultation on its discussion paper on Draft Technical Standards on CSDR (hereafter referred as to the "DP")

Our answers concern matters dealt with by the "DP" regarding settlement discipline and not the others sections which treat subjects outside of AMAFI's core concerns.

Before answering the questions of the "DP", AMAFI would like to emphasise some general comments.

I) GENERAL COMMENTS

AMAFI has always advocated for a sound and efficient system because it is a key element of public confidence in the market. In many European countries, the current situation is satisfactory and especially in France, where fails rates has been at about 1% for several years.

Considering that there is no actual market failure concerning settlement process, ESMA should at first considering costs/benefits analysis, for both CSDs and market participants when drafting technical standards.

ESMA should leverage on what has been already achieved by the industry on settlement discipline, particularly the "Target 2 Securities" (T2S) principals and technical features (e.g. technical netting, recycling ...) and enlarge them to the non T2S countries.

To promote an efficient buy in regime and settlement discipline it is preferable to have a centralised operational entity performing the tasks than a decentralised process applied by each CSD/country.

Timing of implementation of settlement discipline is a key issue for market participants and CSDs. It should be put in place after the move to T2S for the joining CSDs and at the latest in 01/01/2017 for non T2S countries.

AMAFI 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. We are committed to working jointly with the other European associations representing users and market infrastructures to try and develop a workable solution by mid-July in order for ESMA to take this into account when drafting the full technical standards on buy-ins.

II) DETAILED COMMENTS ON 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?**

When a client allocates a trade to a broker, AMAFI believes that the following information should be available. We have stated the fields which should be mandatory and a non exhaustive list of those which may be considered as optional. ESMA should consider how any changes to the mandatory fields could be adopted without full recourse to the regulatory process. Any procedure will need to be flexible and easily accommodate new market requirements.

Allocation Details from Client

- Order ID: optional
- Fund ID: mandatory
- Broker ID: mandatory
- Direction : mandatory
- Stock identifier : mandatory
- Quantity: mandatory
- Price : mandatory
- Trade Date: mandatory
- Value Date: mandatory
- Commission Rate/amount: optional
- Local Charges : optional
- Settlement Currency : optional (mandatory if cross currency)
- Net Consideration: optional
- PSET: optional
- Commission sharing/soft flag: optional
- Accrued Interest: optional
- SSIs: optional

- **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.**

AMAFI understands that this question refers to the CSD services that compel users to intervene manually.

In that respect, AMAFI is in favour of flexibility to be offered for such operations upon users request even if some limits have definitely to be set so that process are as lean as possible.

Eventually, automation does not prevent from non STP intervention through practices such as pre-matching via phone call before the input of the instruction in the CSD system (not feasible any longer in the future T+2 environment).

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

The French market place calls for global Market Practises under the umbrella of ISO and involvement of the SMPG (Standard Market Practises Group).

At least, these Market Practices should be defined in cooperation with other European institutions (such as the European Commission) through a Regional Market Practice Group covering the European Zone.

A Regional Market Practices Group could be the instrumental body to favour European Standards.

- **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?**

First, AMAFI wants to remind that the objective of the matching criteria shall be to limit the fails with 3 main principles to follow:

- It is key that a transaction to be proposed to settlement is being matched (or adjusted) first.
- Free of payment without matching should be allowed for portfolio transfers.
- On top of that, there should be one single tolerance amount per currency, common to all CSDs.

Although AMAFI agrees with ESMA's proposal, it requires for primary markets trades two mandatory additional matching fields:

- Nature of the transaction (primary versus secondary).
- Identification of the client at the custodian level in order to avoid cross- matches.

AMAFI would like to highlight that the list of matching criteria shall not be considered as definitive. Indeed it could change overtime based on new regulations (eg LEI) or new businesses. Therefore any modification to this list should be possible without the need to trigger a legislative action (e.g. without going through the European Commission) so the list shall not be published at EU Official Journal.

AMAFI suggests that the T2S criteria are a good starting point even for non-T2S markets.

- **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?**

AMAFI suggests to keep and if possible to widen as much as possible T2S principals and tools even for non-T2S countries (lower fee for early sent transactions, sound allegation system, hold and release mechanism and bilateral cancellation for matched transactions).

AMAFI reckons there is no need to set-up additional financial incentive mechanisms to penalise late settlement.

In relation to the proposition written in paragraph 23 that settlement instructions not received by the end of ISD-2 should be subject to disincentives, we strongly disagree (time zone should be taken into consideration for example).

To elaborate on this, we indeed consider that there are 3 steps involved in the process trade confirmation and matching:

- First step is the affirmation of the terms of the trade between trading counterparties.
 - Second step is establishing the chain of additional market participants to be involved in the settlement of the trade.
 - Third step is the confirmation
- **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.**

AMAFI's benchmark is to follow T2S features with 2 night batches that deal roughly with 80% of the settlement and then a real time processing settlement for the day. And AMAFI requires their expansion to the non-T2S markets.

- **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.**

AMAFI agrees that CSDs should offer on mandatory basis technical netting, partials, auto-collateral management and recycling of instructions.

- **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.**

AMAFI concurs with the proposal: lending facilities should not be offered by the CSDs on a mandatory basis. It should up to each CSD to decide whether or not they will offer such feature. In any cases, lending facilities should be proposed under an agency model.

- **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.**

AMAFI agrees with the content proposed by the European Commission; however a daily reporting seems too burdensome.

Therefore, AMAFI recommends a monthly reporting frequency (end of month) and ad hoc reporting in case of express demand from the regulators.

On top of that, it is essential that reporting to the regulators is harmonized across Europe (data, fields, templates). AMAFI requests that ESMA elaborates on the country code field meaning.

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

AMAFI highlights the need for having proactive (e.g. before the fails occurs) allegation process from CSDs. Based on properly received information, each participant would then be able to follow its activity and adequately track the 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?**

AMAFI expects ESMA to provide an European template.

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

Please refer to the answer on question 9.

- **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?**

AMAFI suggests that at least a distinction between fixed income and cash equities products should be made for the buy in.

AMAFI is not in favour of an extension period being based on the liquidity (level 1) and recommends making a difference between asset types: for instance equities (4 business days) and fixed income (7 business days).

- **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?**

As stated above (see answer question 13) AMAFI does not consider that liquidity is a relevant criteria to determine the buy-in execution period.

Furthermore, the liquidity of a product must be considered globally in Europe and not on a country per country basis.

Above all AMAFI highlights the need for a buy in duration harmonized across CSDs to prevent arbitrage cross countries on the same ISIN (Cf. Q13).

Buy in procedure follows several steps: buy in extension period, buy in procedure activation, buy in execution period

Each step needs to be harmonised across countries and at least follows the rules defined by the issuer CSD.

- **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?**

AMAFI reckons that the buy in should be irrevocable once triggered.

The accurate operational process has to be defined and communicated by the CSD and be harmonized between CSDs and CCPs.

Unnecessary buy-in shall be avoided hence the first buy-in shall be triggered by the CCP and its consequence/result shared along the market participants as dependency and then down the chain to trigger buy-in on the remaining part.

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

Whenever there is a linkage between two transactions (like T2S feature), when the first transaction did not settle on intended settlement date, AMAFI suggests to replace the buy in process by a netting arrangement with the second transactions of the linkage.

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

AMAFI recommends that cash compensation should always be possible whatever the market price.

AMAFI advice is that the market refers to the CCPs practices and to the ECB prices when they are available.

- **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?**

The suspension of any participant should be considered with the greatest care. There are multiple reasons for a failing trade and these may not be under the control of the intermediary. In a CCP counterparty context, a suspension triggers a default and similar conclusions may be drawn if a participant is suspended at the CSD. AMAFI believes that this should be only be used as a last resort.

Because CSD participants settle instructions on behalf of others, it may not be the participant's fault that the transactions failed. A lack of instructions from the trading participant would ensure a fail. However, consideration is being given to suspending a CSD participant who may not be at fault. The CSD participant would be suspended but their underlying client could simply move elsewhere and continue to trade.

Failure by a CCP to deliver should be taken into consideration for the determination of any threshold, as they often cause participants to fail onward deliveries.

The underlying causes should first be analysed over a sufficiently long period of time. If the decision is taken to suspend a participant, an appeals procedure should be available.

The impact of suspending a participant could also be damaging to the remainder of the settlement process. Again, due care and consideration should be given to the participant's own failures, as opposed to those of its clients.

- **Q19: Please, indicate your views on the proposed quantitative thresholds (percentages / months).**

Please refer to the answer on question 18.

- **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.**

Information that CSDs need to provide to CCPs

It will be sufficient for the CSD to provide the information of the failed transaction to the CCP. In contrast to other situations, the CCP in its position as buyer to every seller and seller to every buyer already is aware of the underlying offender. The CCP can therefore utilise the information provided, along with the trade and cleared level data, to issue buy in notices to the correct party as it does today.

Information that CSDs need to provide to CCPs

Transactions executed on a trading venue but not cleared through a CCP would usually be settled on a bilateral basis. We would question whether CSDs are in a position to determine such transactions as typically the trading venue is not involved in the settlement of those transactions. If however a trading reference is contained in the instruction such information might enable the trading venue to identify the underlying trading participants and hence arrange or manage a buy-in. Alternatively, a CSD may provide information via its CSD participants to the buyer and seller in the transactions. Being bound by the rules of the trading venue, the buyer can then issue the buy in notification, following the Trading Venue agreed procedure.

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

AMAFI agrees with the proposed information gathering rules on settlement internalisation.

For equal treatment reasons, AMAFI reckons that this should also apply to CSDs when they settle on their systems transactions in securities for which they do not assume the notary function.

AMAFI is in favour of the reporting of the "book to book" transaction at the custodian level. Supposedly, a custodian has thorough risk procedures and controls that ensure the quality and of their platforms and services. As a consequence, custodians suggest communicating statistics on settlement on a monthly basis but are not in favour of proving their efficiency for each transaction.

More generally, AMAFI is convinced that a strong legal environment such as the French one covers systematic risk.

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