ASSOCIATION FRANÇAISE DES MARCHÉS FINANCIERS

FINANCIAL MARKET PROFESSIONALS

AMAFI / 21-09
4 February 2021

EC CONSULTATION ON REVIEW OF REGULATION ON IMPROVING SECURITIES SETTLEMENT IN THE EUROPEAN UNION AND ON CENTRAL SECURITIES DEPOSITORIES

AMAFI contribution

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, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities.

AMAFI welcomes the opportunity to respond to this consultation report on the review of CSDR.

Indeed, AMAFI members, are very active in the primary and secondary financial markets on bonds and equities and are therefore very sensitive to certain aspects of CSDR, mainly internalised settlement, CSDR and technological innovation, and settlement discipline.

That is the reason why, and even if all the aspects of the consultation are important, AMAFI only responds to parts 3, 4, 6 and 7 of the consultation document.

AMAFI has liaised with AFME and AFTI to prepare this answer to part 3 and 7and generally agrees with their answers and statements and with ADAN for part 4.

Please note that our main concern is the evolution of the buy-in procedures which are currently impracticable and does not fit the way markets are functioning. This does not mean that AMAFI is *per se* against the setting up of EU rules, but those rules should be efficient to achieve an actual settlement efficiency.

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ANSWERS

3. INTERNALISED SETTLEMENT

Question 15. Article 2 of Commission Delegated Regulation (EU) 2017/391 establishes the data which internalised settlement reports should contain. Do you consider this data meets the objectives of relevance, effectiveness, EU added value, coherence and efficiency?

- **Yes X**
- **No**
- **Don't know / no opinion**

Question 15.1. Please explain your answer to Question 15, providing where possible quantitative evidence and/or concrete examples.

According to AMAFI, there is no reason to modify the current regime. Indeed important investment have already been made in order to implement the regime and there is no actual evidence to consider that it has not delivered the expected outcomes.

This position does not preclude to continue to work on achieving more consistency in the interpretations of the reported figures with the regulator and improve reporting rules in the long term.

Question 15.2. If you are an entity falling under the definition of "settlement internaliser", what have been the costs you have incurred to comply with the internalised settlement reporting regime? Where possible, please compare those costs to the volumes of your average annual activity of internalised settlement.

AMAFI is not in a position to answer this question

Question 16. Do you think that a threshold for a minimum level of settlement internalisation activity should be set for entities to be subject to the obligation to report internalised settlement?

- **Yes, based on the volume of internalised settlement**
- **Yes, based on the value of internalised settlement**
- **Yes, based on other criterion**
- **No X**
- **Don't know / no opinion**

Question 16.1. Please explain your answer to Question 16, providing where possible quantitative evidence and/or examples. Please indicate:

AMAFI does not see any benefit to the introduction of thresholds as it only brings operational complexities. Furthermore, we are opposed to the introduction of thresholds at national level which could be creating potential disparities within the EU and weaken harmonization of the rules.

- **whether you consider that the introduction of such a threshold could endanger the capacity of NCAs to exercise their supervisory powers efficiently.**
- **the cost implications of complying or monitoring compliance with such a threshold**

If you answered "yes" to Question 16, please also consider whether such a threshold should be set at national level or at Union level.

4. CSDR AND TECHNOLOGICAL INNOVATION

Question 17. Do you consider that certain changes to the rules are necessary to facilitate the use of new technologies, such as DLT, in the framework of CSDR, while increasing the safety and improving settlement efficiency?

- **Yes X**
- **No**
- **The pilot regime is sufficient at this stage**
- **Don't know / no opinion**

Question 18. Would you see any particular issue (legal, operational, technical) with applying the following requirements of the CSDR in a DLT environment? Please rate each proposal from 1 to 5.

Definition of 'central securities depository' and whether platforms can be authorised as a CSD operating a SSS which is designated under Directive 98/26/EC (Settlement Finality Directive (SFD))	5
Definition of 'securities settlement system' and whether a blockchain/DLT platform can be qualified as a SSS under the SFD	5
Whether and under which conditions records on a DLT platform can fulfil the functions of securities accounts and what can be qualified as credits and debits to such an account;	5
Whether records on a DLT platform can be qualified as securities account in a CSD as required for securities traded on a venue within the meaning of Directive 2014/65/EU (MiFID II)	5
Definition of 'book entry form' and 'dematerialised form'	5
Definition of "settlement" which according to the CSDR means the completion of a securities transaction where it is concluded with the aim of discharging the obligations of the parties to that transaction through the transfer of cash or securities, or both; clarification of what could qualify as such a transfer of cash or securities on a DLT network/ clarification what constitutes an obligation and what would qualify as a discharge of the obligation in a DLT environment	3
What could constitute delivery versus payment (DVP) in a DLT network, considering that the cash leg is not processed in the network/ what could constitute delivery versus delivery (DVD) or payment versus payment (PVP) in case one of the legs of the transaction is processed in another system (e.g. a traditional system or another DLT network)	5
What entity could qualify as a settlement internaliser, that executes transfer orders other than through an SSS	5

Question 18.1. Please explain your answers to question 18 (if needed), including how the relevant rules should be modified.

In the consultation paper, the European Commission states that they cannot not specify the obstacles that some CSDR rules create for the use of blockchain technologies and the tokenisation of financial instruments. However, both **ESMA** in their Advice on ICO and crypto-assets, the French financial regulator (the **AMF**) in their Legal analysis on the application of financial regulations to security tokens and precisions on bulletin board. AMAF agrees with the ADAN analysis provided below:

- Clarifications are expected whether some crypto-asset platforms, or even blockchain protocols, should qualify or not as "securities settlement system" (SSS) or "settlement internaliser". Such hypotheses were raised by ESMA but have never been substantiated since then.

- Under certain scenarios (e.g when financial instruments are traded on trading venues, or transfered for financial collateral arrangements), the SSS requires to be operated by an authorized CSD. Assuming that crypto-asset platforms or blockchain protocols qualify as SSS, this raise concerns in the case of decentralised infrastructures (decentralised exchanges - DEXs - and "public" blockchains respectively) where there is no legal person operating the DEX or the open network.

- Participants to a SSS must be regulated entities. However, benefits attached to blockchain technologies helped implement a different functioning of markets in crypto-assets where participants can be and are primarily individuals.

- Some national laws pose restrictions to the method used by issuers to record securities in book-entry form, based on criteria from recital 11. Legal certainty is crucial to actors wishing to develop on security tokens, that is it should be widely acknowledged that blockchain technologies would not imply any loss of rights for the holders of securities and would enable holders of securities to verify their rights at any time.

- Finally, rules on cash settlement do not allow for the use of any settlement asset issued and usable directly on blockchains. This is one major issue that limits the full processing of transactions on blockchains and prevents market participants from benefiting from their advantages. In the Adan-AFTI-AMAFI-Gide255 report on Security tokens published in July 2020, more than 90 % of participants which were surveyed claimed for allowing stablecoins to be used for settling the cash leg of transactions on security tokens, or for the creation of a digital euro.

That being said, the question could be raised whether it is time to consider changes to CSDR before the pilot regime shows tangible results.

Moreover, it should be noted that currently CSDs operating DLTs use the DLT as an internal IT system for registering data. The "validation nodes" are not distributed. Given the legislation's technological neutrality, the usage of DLT as internal system without any infrastructural changes does not pose problems. However, where an entity does securities settlement in a DLT, the usage of a CSD might become redundant. This doesn't have to do with DLT as such, but with the fact that DLT potentially opens trade and post trade to the smaller SME's that are currently not admitted to trading (a DLT system is cheaper than a traditional securities settlement IT system). Current legislation prohibits this by imposing usage of a CSD, outsourcing to T2S and settlement in central bank money. This is an overkill for the very small volumes and values of trades that would settle in such a market. By imposing the usage of the CSD (art. 3.2 of the CSDR) without any thresholds as if an SME market, crowdfunding and blueships are identical markets, the regulation prohibits the organisation of transparent price discovery for smaller markets.
It is of paramount importance that granularity is introduced in art. 3.2 of the CSDR. For the smallest companies, transfer of securities must be allowed in the shareholders register directly.

Question 18.2. Do you consider that any other changes need to be made, either in CSDR or the delegated acts to ensure that CSDR is technologically neutral and could enable and/or facilitate the use of DLT?
- **Yes**
- **No**
- **Don't know / no opinion**

Question 18.3. If yes, please indicate the provisions and make the relevant suggestions.

Question 19. Do you consider that the book-entry requirements under CSDR are compatible with crypto-assets that qualify as financial instruments?
- **Yes X**
- **No**
- **Don't know / no opinion**

Question 19.1. Please explain your answer to question 19.

Question 20. Would you see any particular issue (legal, operational, technical) with applying the current rules in a DLT environment? Please rate each proposal from 1 to 5, 1 standing for "not a concern" and 5 for "strong concern".

Rules on settlement periods for the settlement of certain types of financial instruments in a SSS	5
Rules on measures to prevent settlement fails	2
Organisational requirements for CSDs	5
Rules on outsourcing of services or activities to a third party	5
Rules on communication procedures with market participants and other market infrastructures	2
Rules on the protection of securities of participants and those of their clients	5
Rules regarding the integrity of the issue and appropriate reconciliation measures	5
Rules on cash settlement	5
Rules on requirements for participation	5
Rules on requirements for CSD links	5
Rules on access between CSDs and access between a CSD and another market infrastructure	5
Rules on legal risks, in particular as regards enforceability	5

Question 20.1. Please explain your answers to question 20, in particular what specific problems the use of DLT raises.

1. On settlement fails: in a DLT environment, positions can be verified and blocked before the trade is placed on the markets
2. Communication can take place using the DLT and “non validating” nodes provided to participants. The traditional system is overly expensive for the small markets under consideration
3. Cash settlement: likewise, cash can be blocked in accounts before the trade is placed, making the imperative usage of central bank money redundant.

Question 20.2. If you consider that there are legal, operational or technical issues with applying other rules regarding CSD services in a DLT environment (including other provisions of CSDR, national rules regarding CSDs implementing the EU acquis, supervisory practices, interpretation,), please indicate them and explain your reasoning.

6. SCOPE

Question 31. Do you consider that certain requirements in CSDR would benefit from targeted measures in order to provide further legal certainty on their scope of application?

- **Yes X**
- **No**
- **Don't know / no opinion**

Question 31.1. If you answered "yes" to Question 31, please specify what clarifications/targeted measures could provide further legal certainty.
The clarification of the scope of the penalty and buy-in regime would increase legal certainty (*See 31.2 for further details*).

Question 31.2. If you answered "yes" to Question 31, please specify which provisions could benefit from such clarification and provide concrete examples.
According to AMAFI (i) the scope of the penalty regime and the scope of the buy-in regime should be clarified (ii) the scopes of the two regimes should be different.

Scope of transactions subject to buy-in

AMAFI considers that it should be clearly stated that the buy-in regime should not apply to the following operations:

Markets operations which are distinct from a transaction in a financial instrument, for example:

- Collateral management operations, including margin transfers.
- Corporate actions, including market claims which are also markets operations distinct from a transaction in a financial instrument.
- settlement instructions where the party acting as principal is the same for the delivery and receipt such as portfolio transfers or realignments

Transactions for which an alternative well-established mechanism achieving the same objective as the CSDR buy-in (put an end to an outstanding settlement) already exist or for which a buy-in mechanism could create further difficulties rather than improving the settlement process; for example:

- Transactions that are subject to a Corporate Action should also be descoped and buyer protection rules should be applied instead
- SFT related transactions, considering actual industry practice and existing master agreements provisions already in place. Securities Lending and repo are mainly used to provide liquidity to the market, and potentially to reduce fails. Applying buy-in on securities lending could therefore be counter-productive with respect to the objective. There might also be a procyclical effect should there be a buy-in regime implemented for SFT transactions.
- Primary market transactions including Funds subscriptions and redemptions. For such transactions, it should be clarified that they are explicitly out of scope of the buy-in regime. The fact that subscriptions or redemptions of Fund units are instructed against a transfer agent makes the buy-in process irrelevant.
- The buy-in itself.

Scope of transactions subject to penalties

The scope should be a subset of the previous one. For instance, if it is obvious that primary market transactions should not be included, SFT related transactions could be subject to the penalty regime.

Role and responsibility of market actors

The Settlement Discipline Regime would also benefit in our opinion of a clarification of the reference to the "failing participant" which may be interpreted as a participant to a trade or as a direct CSD participant. For example, recital 12 of CSDR presents the CSD's participant as the one who buys or sells financial instruments whereas it most likely intervenes at the settlement level on behalf of its clients. As stated in the level 2 (recital 31), "the parties that originally concluded the relevant transaction should be responsible for the execution of the buy-in". Therefore, a buy-in is an event which can only be addressed by trading parties and not by the settlement agents and custodians who are not principal to the trade.

The article 25 of the RTS should be updated accordingly to make clear that the trading parties responsible for the buy-in process (not custodians or settlement agents) are required to establish contractual arrangements with their counterparties to incorporate the buy-in process. Settlement participants can acknowledge and inform their clients of such provisions, but cannot be held to enforce the provisions on buy-ins, nor be responsible for payment of any costs as outlined in the RTS on Settlement Discipline.

Question 32. Do you consider that the scope of certain requirements, even where it is clear, could lead to unintended consequences on the efficiency of market operations?
- **Yes X**
- **No**
- **Don't know / no opinion**

Question 32.1. If you answered "yes" to Question 32, please specify what targeted measures could be implemented to avoid those unintended consequences while achieving the general objective of improving the efficiency of securities settlement in the Union?

Please referred to our answer to question 31.2.

Question 32.2. If you answered "yes" to Question 32, please specify which provisions are concerned.

Please referred to our answer to question 31.2.

7. SETTLEMENT DISCIPLINE

Question 33. Do you consider that a revision of the settlement discipline regime of CSDR is necessary?
- **Yes X**
- **No**
- **Don't know / no opinion**

Question 33.1. If you answered yes to Question 33, please indicate which elements of the settlement discipline regime should be reviewed: (you may choose more than one options)

- **Rules relating to the buy-in X**
- **Rules on penalties X**
- **Rules on the reporting of settlement fails**
- **Other**

Question 33.2. If you answered "Other" to Question 33.1, please specify to which elements you are referring.

Question 34. The Commission has received input from various stakeholders concerning the settlement discipline framework. Please indicate whether you agree (rating from 1 to 5) with the statements below:

Buy-ins should be mandatory	1
Buy-ins should be voluntary	5
Rules on buy-ins should be differentiated, taking into account different markets, instruments and transaction types	5
A pass on mechanism should be introduced	5
The rules on the use of buy-in agents should be amended	5
The scope of the buy-in regime and the exemptions applicable should be clarified	5
The asymmetry in the reimbursement for changes in market prices should be eliminated	5
The CSDR penalties framework can have procyclical effects	5
The penalty rates should be revised	2
The penalty regime should not apply to certain types of transactions (e.g. market claims in cash)	4

Question 34.1. Please explain your answers to question 34, providing where possible quantitative evidence and concrete examples.

In addition to our response to question 31.2, we would like to make the following comments.

AMAFI strongly supports the proposal that buy-ins should be voluntary with respect to transactions which do not involve a CCP. The option of a voluntary buy-in reduces the burden on regulatory authorities and creates greater flexibility for market-driven solutions. The prescriptive nature of the current regulation (Level 1 and Level 2) will not facilitate the implementation of effective market practices. In parallel, we believe that amendments to the rules regarding buy-in agents are necessary and in particular, we recommend the removal of the mandatory obligation to appoint a third-party buy-in agent.

AMAFI favors the introduction of a pass-on mechanism intended to reduce the number of buy-ins required to remedy settlement fails, particularly where multiple settlements are contingent on a single (failing) settlement. This mechanism should:

- allow a receiving trading party to pass-on the consequences of a buy-in to its failing delivering party and by doing so be considered compliant with article 7 of CSDR (the pass-on mechanism should be seen as equivalent to the obligation to initiate a buy-in).

- allow a trading entity to reject a buy-in initiated against it if a buy-in has already been initiated (or shall be since a CCP is involved) and to pass-on to the trading entity with which it has an in-scope failing delivery the results of the buy-in.

We also support the elimination of “asymmetry” and the replacement with a new provision mandating symmetric settlement of the price difference or cash compensation.

Separately, we support the proposal made by other trade associations for a central database of in-scope securities (and the relevant reference price, penalty rate and extension period). Such database is essential to providing clarity for all market actors and reducing the likelihood of disputes. ESMA should be given a mandate to create and maintain it.

Question 35. Would the application of the settlement discipline regime during the market turmoil provoked by COVID-19 in March and April 2020 have had a significant impact on the market?
- **Yes**
- **No**
- **Don't know / no opinion X**

Question 35.1. Please explain your answer to Question 35, describing all the potential impacts (e.g. liquidity, financial stability, etc.) and providing quantitative evidence and/ or examples where possible.

Question 36. Which suggestions do you have for the improvement of the settlement discipline framework in CSDR? Where possible, for each suggestion indicate which costs and benefits you and other market participants would incur.
With respect to suggestions for improvement, please refer to the previous questions and in particular 31.2 and 34.1.

In addition to the points covered by the question 34.1 we believe there is another area of improvement; it relates to the current way penalties are handled when a CCP is involved. CSDR imposes that CCPs handle the collection and distribution while CSDs do the calculation. In our view there should be a unique process for the all the failing settlements with CSDs being in charge of both the calculation and the collection / distribution. This will simplify the process for the actors and allow them to fully benefit from the CSDR intention to “limit the number of cash transfers” as stated in recital 22 of the RTS.

In line with other trade associations, we suggest that Article 76 of CSDR is amended to separate the date of application of the buy-in regime from the date of application of all other settlement discipline measures. By sequencing the introduction of the buy-in regime to a later date, this allows an opportunity for penalties and other measures to take effect, and for their impact to be monitored and assessed by the authorities. Also, should there be significant amendments to the current buy-in rules, as suggested in the consultation, additional time will be required by all industry participants to adjust accordingly (IT investments, contractual arrangements, etc.).

We do think that we should avoid the situation where the initial regime of settlement discipline enters into force before the one to be agreed in the context of the CSDR review. In other words, except if the review of CSDR enters into force before February 1st 2022, flexibility will have to be granted to postpone this deadline.