CSDR review: State Street response

Introduction

The EU Commission published a consultation paper on the review of the CSD Regulation (CSDR) in late 2020. State Street submitted feedback via the EU survey tool on 2 February. Our comments focused on (i) ensuring a level playing field for when CSDs offer bank-like services, (ii) adapting the framework to allow for DLT settlement of security tokens, (iii) opposing the introduction of a reporting threshold for internalised settlement, (iv) the need for regulatory clarity with respect to the types of transactions in scope of the settlement discipline regime and, importantly, (v) removing the mandatory nature of the buy-in rules as well as recalibrating the penalties framework. The comments to specific questions provided in this document may have been slightly adjusted when responding via the online survey tool given the consultation imposes strict character limitations, but these would be immaterial changes for brevity, the substance remains the same.

Consultation questions

Section 1 – CSD AUTORISATION AND REVIEW & EVALUATION PROCESSES

Question 1. Given the length of time it has taken, and is still taking in some instances, to authorise CSDs under CSDR, do you consider that the application process would benefit from some refinement and/or clarification in the Regulation or the relevant delegated acts?

☐ Yes, some aspects of CSDR or the relevant delegated acts would merit clarification, although no legislative or regulatory amendment would be required.

☐ Yes, the CSDs authorisation process should be amended to be made more efficient.

☐ No, the length and complexity of the authorisation process reflects the complexity of CSDs' businesses.

☐ No, most of the CSDs in the Union have already been authorised under CSDR, there is no case for amending the authorisation process.

☒ Other

Question 1.1 Please explain your answer to question 1, providing where possible quantitative evidence and/or examples.

As systemically important market infrastructures, the CSDs providing services to investors and market participants in the EU should be subject to rigorous and consistent reviews for authorisation and supervision.

We therefore welcomed the robust provisions for such assessments that were incorporated into CSDR. That said, we acknowledge authorisation efforts have been a substantial, multi-year undertaking that is yet to be completed. Therefore, we believe there is scope for the Commission to engage further with CSDs, and other stakeholders, to agree on what additional efficiency measures can be introduced on aspects of the authorisation regime, either through procedural adjustments or refinements to the Regulation, provided that any resulting changes do not compromise systemic risk mitigation principles or level playing field considerations.

Questions 2 – 7 – *State Street did not comment.*

Section 2 – CROSS-BORDER PROVISION OF SERVICES IN THE EU

Question 8. *Question for issuers* - One of the main objectives of CSDR is to improve competition between CSDs so as to enable market participants a choice of provider and reduce reliance on any one infrastructure provider. In your view, has competition in the provision of CSD services increased or improved in your country of establishment in recent years?

☐ Yes

☐ No

☒ Don't know / no opinion

Question 8.1: Please explain your answer to Question 8, providing where possible quantitative evidence and/or concrete examples. Please indicate where possible the impact of CSDR on:

a) the number of CSDs active in the market;
b) the quality of the services provided;
c) the cost of the services provided.

Competitiveness is beneficial for fueling innovation and improved services, although competition levels between CSDs and market demand for alternative providers across EU markets have remained relatively flat since the introduction of CSDR. At the same time, the Regulation itself has produced a positive effect for participants in relation to uniform transparency around CSD fees and high standards for their operations. We would therefore recommend that the Commission engages further with the CSDs, and other stakeholders, to assess whether targeted measures to promote greater competition opportunities beyond those already included in CSDR are warranted.

Question 9 – 14 – *State Street State Street did not comment (most questions addressed to CSDs)*

Section 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

☐ 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.

We understand that the driver of internalised settlement reporting requirements is to review activity levels occurring outside of CSDs, and that the overall regulatory objective is to assess potential risks and whether additional legislation is needed. At the same time, settlement and safe-keeping activities undertaken by intermediaries such as custodians are already subject to high operational and risk standards and oversight from a number of banking requirements and regulatory authorities. In its report to the European Commission in November 2020 ESMA acknowledged that the reporting regime would benefit from a longer period of time to have a clearer picture of settlement internalisation trends. It is therefore not fully clear at this time what benefit additional regulation of internalised settlement activity would bring. As the ESMA monitoring and analysis progresses we would welcome further dialogue and consultation with the Commission in the future on any next steps and potential regulatory actions.

Question 15.2 – *State Street did not comment.*

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 internalized settlement

☐ Yes, based on the value of internalised settlement

☐ Yes, based on other criterion

☒ No

☐ 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:

- **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**

While we appreciate the intention of ESMA's recommendation to introduce a reporting threshold is to reduce the burden of internalised settlement reporting on financial market participants with lower volumes of internalisation, we do not view introducing such an accommodation as essential. Cost impacts for the

reporting requirements where primarily up-front investment needs to set up the reporting capabilities leading up to the start of the obligations in 2019. In our experience the ongoing records maintenance and preparing quarterly reports are not incurring material additional costs. Introducing new threshold requirements would still require firms to retain reporting capabilities if needed in the future and would add the further need to monitor activity levels on an ongoing basis.

Section 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

☐ 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 *[1 – not a concern, 2 – rather not a concern, 3 – neutral, 4 – rather a concern, 5 – strong concern, no opinion]*

CSDR requirements	State Street's rating
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	**5**
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.

As a general point, CSDR, in large parts, assumes the existence of a single CSD per market, with functionalities found previously at CSDs, ICSDs and TARGET2-Securitities (T2S) The successful deployment

of DLT for alternative security token models should not be limited to CSDs, but open to, at least, MIFID-regulated firms (investment firms, MTFs, etc.). Specific comments on the application of CSDR requirements in a DLT environment include:

- The definitions of a 'CSD' and a 'securities settlement system' (SSS) should be revised to allow such regulated firms to operate a securities token SSS using DLT;
- While it would be easy to assume that a public key could be considered an account, a blockchain system implies numerous consequences (e.g. no need for reconciliation between nostro and vostro accounts); hence, the functional approach should reflect this;
- The definition of 'book entry form' is necessarily tied to the existence of a CSD. This strict requirement should be amended to allow for other regulated entities offering DLT-enabled security token issuance models that can be listed and traded on stock exchanges and MTFs;
- The definition of 'settlement' is technologically neutral; and
- The cash leg can be, and in fact is, processed via the DLT network; however, the case in question is not central bank money. Atomic asset swaps, not just in delivery versus payment (DvP) but also delivery vs delivery (DvD) and payment versus payment (PvP), can be enabled through DLT, but any requirement or preference towards central bank money is dependent on a central bank digital currency, in particular, whether central banks will make their currency available on DLT.

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.

CSDR has embedded a framework to address various risks, business, operational, legal, etc. – as they are understood in today's market structure with the CSD being a central actor. A DLT enabled securities system may require a differentiated approach to manage similar risks (for example, who can approve updates to the protocol, what legal obligations are there for data oracles? etc.)

Question 19. Do you consider that the book-entry requirements under CSDR are compatible with crypto-assets that qualify as financial instruments?

☐ Yes

☒ No

☐ Don't know / no opinion

Question 19.1. Please explain your answer to question 19.

The ability to introduce securities for book entry settlement only through a CSD will make many DLT tokenization platforms unviable. DLT systems should enable decentralised market models, not force activity into a single provider, otherwise securities issuance activity could be more active outside of the EU.

Question 20 – *State Street did not comment.*

Section 5 – Authorisation to provide banking-type ancillary services

Questions 21 – 26 – *Questions for CSDs.*

Question 27: In your view, are the thresholds foreseen in Article 54(5) set at an adequate level?

☐ Yes

☐ No

☒ Don't know / no opinion

Question 27.1: Please explain your answer to question 27, providing where possible concrete examples. If you answered "no", please provide where possible quantitative evidence (including any suggestion on different threshold levels).

Entities offering bank-like ancillary services, similar to that of credit institutions and/or CSDs, should be subject to equal scrutiny and regulatory requirements in order to do so in the EU.

Question 28: Do you think that the conditions set out in Article 54(4) for the provision of banking-type ancillary services by a designated credit institution are proportionate and help cover the additional risks that these activities imply?

☒ Yes

☐ No

☐ Don't know / no opinion

Question 28.1: Please explain your answer to question 28, providing where possible concrete examples. If you answered "no", please provide where possible quantitative evidence.

In our view, the necessary conditions on CSDs providing bank-like ancillary services have already been addressed in the current Regulation, as it introduces a separate review and authorisation process, which goes a long way to mitigate any risks and 'unlevel playing field' concerns associated with these services.

Related to the provision of banking-type ancillary services is the broader treatment of an 'issuer CSD' versus an 'investor CSD'. In particular, we recognise the importance of achieving regulatory clarity on the matter of an investor CSD being considered a delegate of the depositary, as well as on how the term "investor CSD" is defined. We refer to State Street's response to the separate consultation on the legislative review of the Alternative Investment Fund Directive (AIFMD), and welcome the outcome of that important discussion.

Question 29 – *State Street did not comment.*

Question 30: Are there requirements within Title IV of CSDR which should be specifically reviewed in order to improve the efficiency of the provision of banking-type ancillary services to and/or by CSDs while ensuring financial stability?

☐ Yes

☐ No

☒ Don't know / no opinion

Question 30.1 Please explain your answer to question 30, providing where possible quantitative evidence and/or concrete examples:

While we do not have specific comments on Title IV of the CSDR, we reiterate the importance of ensuring the same conditions for CSD authorization to offer bank-like services as would be required of any other entity.

Section 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

☐ 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.

There are still significant ambiguities with respect to transaction types in scope for the Settlement Discipline regime. In our view, the ongoing ambiguity creates tremendous uncertainty for firms attempting to implement these measures.

In terms of targeted measures, we recommend consistent application of the terminology across level 1 and level 2 texts: the term "participant", including references to 'failing participant' and 'receiving participant', is used inconsistently throughout the Level 1 text and we are concerned that this may result in different approaches to implementation and expectations by various market actors across the settlement chain. As highlighted in the response by the Association of Global Custodians, a buy-in is a trading event which can only be addressed by the trading parties and not by custodians in the chain who are not principal to the trade. Unless the trading party is itself a direct participant of the CSD, the role of CSD participants, such as global custodians, should be limited to the transmission of settlement information in the buy-in process without any liability under CSDR. Any errors in the transmission of settlement information should be managed through the custody agreements between the custodian and its clients. We refer the EU Commission to the AGC's response for further details on this important point, and agree with the recommendation to amend the level 1 legislation to adequately reflect the role of the custodian – see further details in Q32.2.

Overall, it would be helpful if the EU authorities could provide a definitive list of securities (or ISINs) as well as clarity on transaction-types that are in scope of the settlement discipline measures. In addition to concerns regarding the application of settlement discipline measures to the following transaction types: corporate action instructions, primary market transactions such as ETF share creation/redemption, margin / collateral transfers, securities finance transactions (SFTs), and technical-only instructions (for example T2S automatic realignments), we would highlight the following:

- Corporate Actions: when the underlying instrument is subject to a corporate action, it would be more prudent to rely on existing measures on buyer protection to ensure that the receiving party can benefit from the corporate action proceeds, rather than initiating a buy-in on an instrument which will already be under pressure from a liquidity perspective.
- Instructions for primary issuance and placement: mandatory buy-in requirements would be particularly disruptive to primary market transactions like Exchange Traded Products (ETP) creation/redemption, given it would significantly increase the operational burden on ETP market participants without any tangible improvement in market functioning. Ultimately, such inefficiencies weaken investor protection measures and thereby have a material detrimental impact on end-investors, both in terms of the value of their investments and the prices with which they are presented in the market (we refer to our letter, co-signed by State Street Global Advisors along with other ETP providers, highlighting the potential impact of mandatory buy-in that we shared with the EU Commission and ESMA in July 2020).
- Securities lending: although Article 7 of the Regulation provides an exemption for securities repos or lending agreements from the buy-in process, it is unclear whether this currently also applies to 'open' or 'rolling' trades, and evergreen trades. As noted further in Section 7, our strong preference is that SFTs are excluded from the mandatory buy-in requirement altogether. If this is not to be the case then, at a minimum, clarity on the scope should be provided.
- Margin / Collateral transfers: margin is an important risk-mitigation tool for cleared and uncleared derivatives as well as for securities lending transactions where one party temporarily exchanges securities against the receipt of collateral. The party that receives the collateral does not wish to receive a specific financial instrument. It is common practice for parties to agree multiple collateral sets which include a variety of different financial instruments. What matters is the receipt of enough eligible collateral so that the receiving party is protected in the event of default by the other party. Therefore, a mandatory buy-in regime for margin transfers would be counterproductive and would likely increase the receiving trading party's exposure to the posting / failing party as the receiver will remain uncollateralised until the buy-in is carried out. We are of the opinion that parties should continue using the existing mechanisms that are available under their trading and collateral documents to deal with settlement fails arising in the context of margin transfers. We recommend that the CSDR settlement discipline regime is amended to clarify that margin transfers are not subject to the mandatory buy-in requirements.

Question 31.2 If you answered "yes" to Question 31, please specify which provisions could benefit from such clarification and provide concrete examples.

As a general matter, we are supportive of various industry responses that represent a cross section of interests, specifically the Association of Global Custodians (AGC), the International Capital Markets Association (ICMA), the International Securities Lending Association (ISLA), the International Securities and Derivatives Association (ISDA), the European Fund and Asset Management Association (EFAMA) and the Investment Association ("the Associations"). In line with their responses, we believe that the scoping clarification is necessary in order to apply provisions in relation to penalties and mandatory buy-in under the Settlement Discipline regime, and we have outlined in our response to Q. 31.1 those transactions where it is unclear how such provisions would apply – see also further details in Q. 32.1 and in Section 7.

The concerns that we have noted above in relation to scope become most challenging when applying the mandatory buy-in provisions under the Settlement Discipline regime, hence they become less problematic if and to the extent the mandatory nature of the buy-in requirements are removed. However, even if the EU Commission were to consider implementing buy-in rules on a discretionary basis, the issues with scope would still need to be addressed to ensure alignment with the penalties framework.

In addition, we agree with industry responses noting that the current CSDR settlement discipline provisions creates legal uncertainty as a result of (1) the ambiguity with respect to transactions in scope of the buy-in rules, in addition to (2) their broad geographic scope, and (3) the means of enforcing such rules in accordance with that geographic scope.

On (2) & (3), we agree with industry responses that the extraterritorial application of buy-in requirements will likely have unintended consequences as trading parties located in third countries will be unable to comply with the EU/EEA buy-in rules. There is, therefore, uncertainty as to what impact the buy in rules would have on their contractual arrangements with their service providers like State Street. We would ask that the EU Commission consider clarifying that the scope of these rules would not apply to transactions between trading parties located outside of the EU/EEA given they will already be subject to home regulatory requirements.

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

☐ No

☐ Don't know / no opinion

Question 32.1 If you answered "yes" to Question 32, please specify which provisions are concerned.

Please see our responses to Q 31.1, Q 31.2 and Q34.1 collectively.

In short, the penalties framework laid out in CSDR should go some way in improving settlement discipline measures and efficiency in the EU, provided that there is timely regulatory clarity on transactions in scope of such measures, as outlined above. Implementation timing, and the readiness of firms and market infrastructure, will depend upon the extent to which changes to other aspects of the settlement discipline regime affect the penalties framework. In any case, we believe that the penalties regime should be subject to an impact assessment following implementation, with a view to potentially recalibrating the penalty rates, for the reasons we have already set out above. We disagree, however, with the introduction of mandatory buy-ins during this time, particularly given the expected pricing and market liquidity impacts.

For example, applying mandatory buy-in rules to securities financing transactions would likely result in fewer market participants wishing to operate in the securities lending market; in addition, we agree with ISLA that the imposition of mandatory buy-ins could result in multiple buy-ins, in respect of the same delivery obligation, when in fact only one party in the chain was actually seeking delivery (thus disrupting the price at which the securities are bought and the likelihood of actual delivery). As an example, State Street Global Advisors (SSGA) sells 10,000 shares of a security, half of which are subject to a securities lending contract and the other held in custody. Upon settlement date, the counterpart to the securities lending contract fails to return securities to SSGA, meaning SSGA is only able to partially settle their sales contract (5,000 shares), however, the purchaser refuses to accept partial delivery/settlement, thereby resulting in a settlement fail for full amount (10,000 shares). Therefore, this failure would trigger mandatory buy-in, thereby incurring buy-in costs and penalties. Absent clarity on the types of transaction in scope of the settlement discipline measures, it is unclear as to whether SSGA would be able to pass on these costs to the borrower. In addition, SSGA is exposed to the market risk on 10,000 shares as a result of the mandatory buy-in.

Another example would be the adverse impact on applying mandatory buy-in rules to Exchange Traded Funds (ETFs). With respect to an ETFs' underlying primary market orders, the imposition of mandato4ry buy-ins would significantly reduce the operational efficiency of authorised participants (APs) and market-makers, particularly where APs need to source an ETF's underlying securities, and exacerbated by the 'second-order effects' in terms of pricing via larger bid-ask spreads for investors seeking to buy or sell ETF shares in the secondary market.

The settlement discipline measures should be revised to allow for differentiated approaches to buy-in (i.e. relying on well-established contractual remedies) based upon specific market need, to permit a 'pass on' mechanism, to address the asymmetry for failed trade reimbursements, and to remove the requirement to appoint a buy-in agent.

Furthermore, Article 25 of the Settlement Discipline Regulatory Technical Standards (RTS) puts obligations on the settlement chain to ensure the buy in process is effectively applied. However, the custodian is not a party to the transaction, nor is it privy to the trading arrangement; we believe that it is therefore necessary to amend

Article 25 so that it refers solely to the trading parties rather than the custodians to ensure that the buy-in requirements set out in the Settlement Discipline RTS are met.

Question 32.2 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?

We support the suggestion outlined by the AGC in its response that includes draft amendments to Article 25 that remove the contractual obligations on custodians in relation to the buy-in process.

Section 7 – Settlement Discipline

Question 33: Do you consider that a revision of the settlement discipline regime of CSDR is necessary?

☒ Yes

☐ 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

☒ Rules on penalties

☐ Rules on the reporting of settlement fails

☐ Other

Question 34: The Commission has received input from various stakeholders concerning the settlement discipline framework. Please indicate whether you agree *[1 – disagree, 2 – rather disagree, 3 – neutral, 4 – rather agree, 5 – strongly agree, no opinion]*

CSDR requirements	State Street's rating
Buy-ins should be mandatory	**1**
Buy-ins should be voluntary	**5**
Buy-ins should be differentiated, taking into account different markets, instruments and transaction types	**4**
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	**No opinion**
The penalty rates should be revised	**5**
The penalty regime should not apply to certain types of transactions (e.g. market claims in cash)	**5**

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

Mandatory buy-in: We have contributed to various industry positions and analysis, particularly those provided by the Associations, evidencing the detrimental impacts of these provisions, with respect to market liquidity and pricing, one important example would be the impact to securities financing transactions, as well as costs to investors (including unquantifiable impacts borne from behavioural change resulting from less liquid markets) and the operational complexity on intermediaries, amongst others. The mandatory nature of the buy-in process should be abandoned altogether, and instead market participants should continue to rely upon the well-functioning existing contractual remedies that are designed to improve settlement efficiency. Should the trading party being failed-to choose to initiate a buy-in under existing contractual terms for their respective market, the obligation would, in effect, be mandatory as an enforceable contractual provision. In any event, we do not think that it is appropriate to require custodians to establish contractual arrangements with their clients that incorporate the buy-in process, given the responsibility for buy-in is placed squarely at the trading level, in which the custodian is not directly involved. Again, we would highlight the potential adverse consequences should certain transactions be subject to a mandatory buy-in regime in CSDR, as noted above in Q 31.1, but also further explained in the various Associations' responses.

Differentiated buy-ins: The rules on buy-ins should be differentiated in accordance with different markets, instruments and transaction types. Imposing a prescriptive, regulatory, 'one-size-fits-all', buy-in framework on the market (even through the appropriate regulation) is sub-optimal: not only from an industry-wide implementation perspective, but more importantly in terms of the likely outcomes and market impacts. Buy-ins can be an effective tool but only when the needs and preferences of trading counterparties are taken into account. In addition, lending transactions are already governed by contractual arrangements between counterparties that include provisions to address the potential for settlement fails; and, moreover, we would like to point out that securities financing transactions, for example, are widely used to reduce settlement fails in the cash market.

Pass-on mechanism: It is essential to the effective and safe operation of a contractual buy-in regime in order to maintain market stability, protect liquidity and to reduce the operational burden and complexity on the trading parties and their intermediaries across the settlement chain which adds, rather than reduces, risk to European capital markets.

Buy-in agents: We believe that the requirement to appoint a buy-in agent should be removed, primarily because the non-failing party initiating buy-in should have sufficient flexibility to independently manage the process, particularly as the appointment of a buy-in agent does not guarantee increased liquidity or best execution. It is also worth pointing out that, currently, there is only one designated buy-in agent in the EU, and we are concerned that this could give rise to, at the very least, inefficiencies in the market. With only one viable provider in the EU, there is also the potential for concentration risk, as well as other competition issues (such as fees transparency). The low uptake of assuming the role of a buy-in agent is presumably a result of a broader set of factors such as heightened reputational risk associated with trying to execute a buy-in,

especially in less liquid markets, and so we do not envisage these issues being addressed aside from removing the requirement outright.

Scope: See response to Section 6, question 31.1, for details on ambiguities around the intended scope of the application of buy-in provisions. Much of the cause of this ambiguity seems to stem from the fact that CSDR Article 7 does not distinguish between a market trade (i.e. the outright purchase and sale of a security) and a settlement, noting that the latter could apply to a whole range of transaction types or processes.

Asymmetry payments for buy-ins / cash settlement: The CSDR RTS suggest an asymmetrical treatment for settling the price differential between sellers and purchasers in the cases of both a buy-in and cash compensation/settlement. In practice, this means that every purchaser of a security is given a free option to benefit from a market drop below the original transaction price to the detriment of the seller. The impact is likely to be reflected either in a wider bid-offer spread, or reduced liquidity provision for less liquid instruments, which, ultimately, disadvantages the failed-to party that CSDR is intending to protect.

Procyclicality: we do not believe cash penalties contribute to procyclical risk, but this only to the extent that they are appropriately calibrated and can be adjusted dynamically in response to changes in short-term interest rates. As such, we believe that the penalty rates should be recalibrated given economic factors can change; such rates may not be effective if the value of that rate decreases or, in instances of extreme market volatility, the ability to process settlements in time is hampered. The EU Commission should therefore consider revisiting the impact of such rates based upon external, economic or market events that impact ability to process settlements on time.

Penalty rates: The cash penalty mechanism can be an effective means of improving settlement discipline in European capital markets. While we would support some refinements that aim to simplify the calculation of penalty rates (e.g. establishing a single database to reference rather than a variety of sources), as well as the possibility to recalibrate such rates for the reasons outlined above and the application of penalties to certain transactions, we strongly caution against any substantial changes, not least given the considerable cross-industry effort that has already been undertaken.

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

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.

We have contributed to responses prepared by the previously mentioned Associations and refer the Commission to the various pieces of evidence that they have outlined in their respective responses that

demonstrate the overall adverse impact of the settlement discipline measures on markets and actors. In particular, the market turmoil experienced in March/April 2020 and impact on liquidity and pricing should provide EU authorities with good datasets to assess the impact of the settlement discipline measures as currently drafted.

By way of example, we support the views of the EU asset management industry (EFAMA and the Investment Association) emphasising that the application of the settlement discipline regime during the market volatility, experienced as a result of the Covid-19 pandemic in March/April 2020, would have had a significant negative impact on the market from a liquidity perspective. In fact, the mandatory buy-in provisions would have likely amplified the situation, particularly with respect to bond markets and certain segments of equity markets where the underlying securities are implicated. This, in turn, could have disincentivised Authorised Participants (APs) and market-makers from providing their important services to ETP providers, potentially creating further liquidity pressures at a time when the market was already under stress.

In addition the international capital markets association, ICMA, similarly highlights the extreme stresses on bond market functioning and liquidity as a result of the peak of the pandemic, which are well-documented in a number of papers issued by regulators (listed by ICMA) that ultimately seek to describe how volatility spiked significantly, market liquidity became severely impaired, and, in some instances, bond markets became dysfunctional. ISLA and ISDA also provide reference to various impact studies and market analysis on securities lending and derivatives markets, which we have contributed over the years.

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.

As an overarching comment, while we very much welcome the EU Commission expanding its review of CSDR to consider revisions to the settlement discipline measures, we have concerns about how the timing of the review will interact with firms' ongoing implementation and readiness planning of the measures as currently drafted. In essence, we believe that the EU Commission should signal as soon as possible following the conclusion of the consultation process which changes it will push forward and what parts of the settlement discipline regime will remain in place. This will allow participants to have certainty as to what needs to implemented by February 2022 and what may be deferred to a longer timeline. Given the specific challenges and problematic elements of the buy-in process in CSDR, including the undertaking of significant contractual repapering, as outlined in our response, we urge the Commission to further review, amend and/or delay the introduction of the mandatory buy-in rules.

Subject to necessary clarifications around which transaction-types are in scope of settlement discipline, we reiterate our overall recommendation to proceed with implementation of cash penalties for settlement fails as currently scheduled, with a view to recalibrating the rates used to calculate such penalties following a thorough impact analysis. This should improve settlement efficiency and significantly reduce the volume of

settlement fails in the EU. It is imperative, however, to abandon implementation of any regulatory requirement to instruct a buy-in for a failing in scope transaction, as this a) should be at the discretion of the receiving party, and, importantly, b) could conflict with existing contractual arrangements and best practices, which we consider to be sufficient, and c) distort market liquidity and pricing, amongst other things.