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Targeted consultation on the review of the Regulation on improving securities settlement in the European Union and on central securities depositories

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Clearstream Banking AG Response Annex

Please kindly see below the responses from Clearstream Banking AG to the following questions:

Question 7

Question 8.1.

Question 18.1.

Question 20.1.

Question 34.1.

Question 35.1.

Question 36

Question 43

Question 7: How do you think ESMA's role could be enhanced in order to ensure supervisory convergence in the supervision of CSDs (for example with possible further empowerments for regulatory technical standards and/or guidelines, or an enhanced role in supervisory colleges, or direct supervisory responsibilities)?

We propose the following measures:

1. Increasing convergence through targeted amendments:

a. **CSDR ESMA Regulatory Technical Standards (RTS) 2017/392, Article 70** describes the operational risk-management system and framework that a CSD needs to have in place. Paragraphs 3 and 6 describe the operational reliability objectives that a CSD needs to define, document and report on. European CSD Association Members appreciate that the Eurosystem has provided its interpretation on (1) what constitutes the criteria to determine the operational reliability of a CSD and (2) how such needs are to be presented to the Participants. We can observe, however, that the Eurosystem interpretation does not seem to be applied evenly and thus gives rise to an unequal level playing field between CSDs.

b. **CSDR ESMA RTS 2017/392, Article 55, Position Records:** There is a need to clarify or amend this article, further to a Target2-Securities (T2S) incident at the end of May 2020. This incident led to incorrect and even negative balances for some securities. It triggered the need for CSDs to decide whether or not to suspend settlement on impacted securities. In our view, suspension of settlement by some CSDs aggravated the situation and hence should be explicitly avoided for this type of incidents.

c. **Legal Entity Identification (LEI):** CSDs need to receive a valid LEI from the issuer before being able to process its issuance. It could be made clearer however, that CSDs have no responsibility when it comes to the issuer renewing its LEI (i.e. same obligation as trading venues) and cannot lead to removal of securities from the Securities Settlement Systems (SSS) (although the issuer will not be allowed to issue new securities without a valid LEI).

d. **Settlement Discipline Regime (penalties):** unless ESMA would be empowered to provide a central single database allowing all stakeholders to derive all necessary information from one official source, it would be helpful to have a formal statement from ESMA on the usage of the ESMA databases to determine which securities are in the scope of the penalties. The current assumption, on which basis all CSDs are proceeding, is that the scope relates to 'All International Securities Identification Numbers (ISINs) included in Financial Instruments Reference Data System (FIRDS) database (Markets in Financial Instruments Directive or MiFID, scope) (minus) All ISINs included in Security Sector Reform (SSR) (Short Selling database)'. While this assumption has never been officially approved by ESMA (no Q&A), it follows ESMA guidance that we received during bilateral discussions.

e. To **add the possibility of cash collateral in the list of High-Quality Liquid Assets:** Although cash is de facto accepted as collateral today, this type of asset is not specifically mentioned in the legal text. For legal certainty reasons and to avoid undue debate, this omission should be corrected.

2. We see benefit in clarifying the interaction between CSDR and other financial legislation / global standards that impacts—directly or indirectly—the CSD and its regulatory regime.

a. **Regarding Committee on Payments and Market Infrastructures-International Organization of Securities Commissions (CPMI-IOSCO):** Apart from obtaining and maintaining its CSD licence, a CSD will typically be requested by authorities to demonstrate compliance with the CPMI-IOSCO principles. The CSDR however, already reflects and integrates those principles. In the report on the implementation of CPMI-IOSCO Principles (p.24), the CSDR is mentioned as a way of implementing the Principles with regard to EU CSDs by the European Union. There should be clarity that there is no further need to additionally comply with CPMI-IOSCO Principles, as soon as the CSD obtains a licence under CSDR. EU should reach some type of arrangements at the level of CPMI IOSCO that other countries recognise CSDR as the EU equivalent of CPMI-IOSCO standards. This will avoid CSDs having to duplicate the demonstration of compliance with Principles for Financial Market Infrastructures (PFMI) to various authorities, as it should be sufficient to demonstrate compliance with CSDR (once).

b. Regarding Markets in Financial Instruments Package (- MiFID/ Markets in Financial Instruments Regulation, MiFIR): The application of MiFID to CSDs is organised in CSDR. While MiFID generally excludes CSDs from its scope, Article 73 CSDR does foresee some circumstances where MiFID can apply and, in that case, only disapplies a very limited number of articles in MiFID for CSDs. Issues arise when compliance is required under MiFID for elements that are also governed by CSDR and for which there is inconsistency between the requirements of MiFID against those of CSDR. Areas linked to, for example, management of conflict of interest or recordkeeping, are meant to be governed by CSDR and hence requirements under MiFID should not be imposed on CSDs. A better mapping between the two texts should be performed to identify and address all overlaps posed by MiFID II (Directive 2014/65/EU).

c. Regarding Payments Services Directive II (PSD II): Some of the services that non-banking CSDs wish to develop in order to service small issuers would fall in the remits of the banking-ancillary services. Such service development should however not be perceived as falling in scope of PSD II payment services, when these are strictly pursued as intended under CSDR, i.e. to support the processing of corporate actions, including tax, general meetings and information services. PSD II explicitly excludes payment transactions carried out within a settlement system and, hence, should not be deemed relevant for authorities when assessing a new service provision by a CSD.

d. Regarding Capital Requirements Directive Package (Capital Requirements Regulation, CRR) and (Capital Requirements Directive, CRD): In order to avoid undue discussion with NCAs and for the benefit of consistency in EU legislation, we believe further clarity could be shed on the interaction between CRR/CRD and CSDR which is particularly important for CSD groups which include one or more entities with a banking license. We would suggest:

1. An explicit acknowledgement of the co-existence of the CRD with CSDR. If there is a banking licensed CSD in a group of CSDs, CRD will inherently affect the non-banking licensed CSDs due to the application of CRD requirements at consolidated level through the holding company (for example a group approach for Risk Management and Audit). Meaning, the recognition (as in article 49 of CSDR ESMA RTS 2017/392) that some key functions of a CSD (group functions or shared services) can be exercised at group level and that this should not lead to additional supervisory requirements at CSD level and the supervision of group functions should be much better organised at EU level with proper coordination among authorities and recognition of supervisory responsibilities of other EU authorities. A similar approach exists already in post-trade legislation, i.e. delineating the extent to which banking legislation is relevant to stock exchanges and central clearing counterparties (CCPs). MiFID II has for example, explained in great detail how it applies to credit institutions with a banking license under CRD that perform investment services and activities for purposes of MiFID II. As such, there would be more legal clarity and consistency if we were to have such clarifications in the context of CSDR

too.

2. The other way around, we also think that requirements under CRD to banking groups that include CSDs should consider the specific EU supervisory regime for CSDs. On topics covered by both CRD and CSDR (e.g. outsourcing requirements), it should be sufficient for the parent company to ensure that CSDs in a banking group comply with CSDR without having regard to, for example, EBA Guidelines on outsourcing for those CSDs. As a result, for non-banking CSDs in a banking group, the requirements in CSDR should prevail over the (indirect) ones in banking legislation when the CSD and its services are the area of concern. Especially on topics where requirements in banking legislation go beyond what has been decided as appropriate under CSDR (for example capital requirements, recovery and resolution). Particularly additional requirements arising from the application of the national transposition of the Bank Resolution and Recovery Directive (BRRD) on CSD authorised to provide banking type ancillary services in accordance with Article 54 CSDR contradict the dedicated requirements on winding down capital as specified by CSDR.

3. Finally, a better alignment between CSDR and CRD could allow for the creation of synergies at group level. It could, for example, allow a group of CSDs to leverage its structure to manage liquid assets as capital buffer for all CSDs in a pooled way, i.e. in a mutualized fund structure, while still assuring the autonomy of each CSD in managing its capital and with careful consideration to maintain the right balance between cash versus liquid assets. The investment in liquid assets warrants the appointment of an external asset manager, which is not viable for a small CSD on a stand-alone basis. Such group set-up in our view does not conflict with CSDR. From a risk point of view, such set-up is preferred to one where CSDs use cash deposits in universal banks which could create undue risk.

For those CSDs that are part of a group in which there is a banking-licensed entity, their ability to organise themselves as a group with both 'group' functions and 'shared' functions (as expressly foreseen in article 49 of CSDR ESMA RTS 2017/392) should be facilitated. Such organisation should not lead to additional supervisory requirements at the level of each individual CSD, nor to the duplication of functions. We suggest that the supervision of group functions at EU level is improved with proper coordination between authorities and recognition of supervisory responsibilities of other EU authorities.

e. Regarding the Bank Recovery and Resolution Directive (BRRD): In order to avoid undue discussion with NCAs and to the benefit also of consistency in EU legislation, we believe further clarity could be shed on the interaction between BRRD (requiring a recovery plan) and CSDR (requiring a wind-down plan), particularly important for CSD groups that include one or more entities with a banking license. We note that a similar approach exists for CCPs that are governed by European Market Infrastructure Regulation (EMIR): as an exception, BRRD contains a specific regime of resolution for CCPs having a credit institution authorisation. While CSDs without

a banking license should be subject to CSDR requirements only, considering that CSDR includes a specific CSD regime on such matter.

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.

EU CSDs are able today, within the framework of CSDR, to effectively allow issuers to reach out to investors based in different markets (both in Europe and beyond, and in Commercial and Central Bank Money). To illustrate this, according to our experience, different institutions use different issuance mechanisms to fit their needs, benefitting from a competitive offering. Across Clearstream entities alone, we have

- The European Investment Bank (EIB) currently using different issuance mechanisms.
 - o International CSD (ICSD) for International Bonds,
 - o US service provider for Global bonds
 - o Domestic CSDs if a specific investor base is targeted.
 - o Under main programme Euro Area Reference Note (EARN), issuance largely goes via ICSD

- The European Stability Mechanism (ESM) issuing today all its EUR denominated debt through another Deutsche Boerse Group CSD - Clearstream Banking AG.
- The European Commission SURE Program, which goes through the ICSD Model is benefitting from remarkable success.
- Today one large US dealer uses another Deutsche Boerse Group CSD - Clearstream Banking AG. to passport issuance into France and a French Bank uses another Deutsche Boerse Group CSD - Clearstream Banking AG to issue securities for sale into Spain

Within in the context of CSDR, the T2S platform set ambitious goals in terms of enabling greater competition between European CSDs / issuing venues. Results so far have been mixed. T2S has delivered greater harmonisation across many areas and this has created a more competitive landscape for European issuing venues. Additional CSDs have emerged, like e.g. ID2S, based on innovative blockchain technology and several initiatives by various market participants have been set up. At the same time, work remains to be done to create a truly open European market for securities issuance.

The EU attractiveness against international issuance locations depends on addressing the inefficiencies; this must be the driver for any future legislative initiatives framing Financial Market Infrastructures (FMIs), particularly from a technological dimension – ongoing and future market-lead initiatives in this regard could be blocked or jeopardised otherwise. We mustn't forget that CSDR has added significant cost for infrastructure suppliers.

As for possible solutions to contribute to a more efficient issuance market in

the EU:

a. Issuer choice enhancement

CSDR has facilitated the free access to a chosen CSD by the issuers, improving securities settlement in the EU.

Clearstream Banking AG and the Deutsche Boerse Group are ready to support the European market via its existing issuance mechanisms. Clearstream Banking AG and the Deutsche Boerse Group offer multiple solutions to issuers. The ICSD model's flexibility plays an important role, particularly around the multiple currencies that are supported (→100 currencies), and the flexible approach to acceptable governing laws (around 50 jurisdictions available). The CSD offers direct access Target 2 Securities with settlement at cost in central bank money. Given the multiple choices available, Clearstream Banking AG and the Deutsche Boerse Group enable over 14,000 supranational, sovereign, and corporate issuers to reach investors across Europe and the world.

The CSDs of the Deutsche Boerse Group, there included Clearstream Banking AG, enable issuers and their agents to reach investors across several markets. Clearstream Banking AG and the Deutsche Boerse Group have developed here a solution to act as a "European Issuer Portal", by using Clearstream as the gateway to T2S markets, issuers benefit from lower costs through the consolidation of issuance in a single place and an extended reach to international and domestic counterparties. The European Issuer Portal has been taken up (primarily in Structured Products) by French Issuers issuing via Clearstream Banking AG into Netherlands and Spain, by Dutch Issuers issuing via Clearstream Banking AG in Netherlands and by UK based Issuers centralising European Issuance in Clearstream Banking AG to passport products into France.

The more CSDs available, the more choices the issuers have; they benefit also from the freedom to choose the source of funding outside their domestic market in accordance with its own legal framework. However, the remaining harmonisation, Regulatory, Legal and Fiscal constraints must be lifted, to achieve tangible progress. Shortcomings still exist in the possibilities of competition between CSDs – we highlight here particularly the cross-border inefficiencies in the existing regime, as outlined in our response to Question 9.1.

Multiple Market initiatives move into the right direction to bring the issuance process forward. CSDR and T2S were meant milestones to support organising a level-playing field. However, the European Landscape is missing harmonization and standardization to bring the process forward. Definitions and requirements differ market by (European) market, depending on Governing Laws applied, supervising authorities, listing requirements, CSD / ICSD requirements, as well as operational complexities very often stemming from differences in Fiscal rules.

Further complexity has been brought in, e.g. in actual application of CSDR Art 23, whereby multiple authorisations have to be sought from NCAs authorities before issuance in foreign governing law can be granted. Standardisation and harmonization is key to unlock the efficiency on a European level to issuers

and all stakeholders of issuance processes.

Clearstream Banking AG and the Deutsche Boerse Group will welcome here any effort in this regard to harmonize the standardization of definitions and requirements. In fact, Clearstream together with "Origin Markets" – a FinTech provider in the field of digital origination processes - actively works on a proposal for a common set of data point and definitions to act as a change agent in this important field.

b. Improving issuer services by CSDs

eMISSION:

- Clearstream Banking AG's automated issuance platform "eMISSION" serves as the heart of the European Issuance Portal providing high-volume, cross-border, multi-currency and multi-asset type solutions to reflect today's capital market dynamics, regulatory environment and investor demand. eMISSION contributes to the goals of the European Issuer Portal to harmonise the fragmented issuance landscape, since issuers and their agents can use eMISSION to reach investors across several markets. This efficient issuance process allows for further product diversification, a larger offer on a pan-European basis and acts as enabler for growth.

- Pre-Issuance and "Origin Markets": Clearstream has partnered with "Origin- Markets", together with Luxembourg Stock Exchange in order to establish a digital end-to-end, straight-through-processing issuance platform for international fixed income capital markets, enabling electronic listing and settlement with goal to achieve T+0 issuance.
 - o Shortly (Q2) listing and ISIN allocation are integrated as part of the electronic documentation service
 - o with integrated issuance and settlement to follow gradually end of this year and in the course of next year.
 - o This process will foster integration between pre- and post-trade issuance and allow for end-to-end straight-through processing.

Paper-Less, Dematerialisation, Instant Issuance:

- Clearstream supports further a paper-less and dematerialised, digital environment, and with LuxCSD S.A. already today is able to issue dematerialised securities under Luxembourg Law. Clearstream Banking AG and the Deutsche Boerse Group welcome and fully supports the changes of law in Germany and at European level.
- Clearstream Banking AG and the Deutsche Boerse Group's view is clearly to move towards a zero-paper, zero-touch, straight-through processing (STP) issuance process that prepares for the market to move towards higher-frequency issuance in smaller denominations.
- Decentral structures, Token, Smart Financial Instruments:
Clearstream Banking AG and the Deutsche Boerse Group are also fully engaged to prepare for the next technological evolution and progress on distributed ledger technology (DLT) which will bring further efficiencies into

the issuance process. Data will be shared across multiple stakeholders: stock exchanges, regulators, data providers, CSDs, issuers, agents, dealers, investors simultaneously making large reconciliation efforts redundant. At the same time, it will create not only transparency in static data, but also make investor data available to issuers. Last but not least, tokenization and “Smart Financial instruments” will enable an automatic process of post-issuance corporate events, reducing operational errors and increasing operating efficiency.

The private sector proves here to be a vector to move the issuance process further and take up the technological challenge, with clear benefits EU market harmonisation. State-run market solutions should only rise when there is clear failure from the private sector, and are mostly incompatible with the Capital Markets Union (CMU) and with western-world capital markets requirements and expectations.

Ultimately these efforts will benefit the public- and private sector issuers, allowing for different issuance models that suit each individual use case. Furthermore, this will ensure a resilient European Market that is up to the latest technological standards, without reliance on a single provider.

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

The approach from the Commission to consider a pilot regime with a sandbox approach raises several concerns in relation to the possibility of new entrants to circumvent the CSDR requirements and introduce new systemic risks to the post-trade market. We recall that the original goal of CSDR was to cater to market integrity. Therefore, a balance between this and the quest for innovation should be achieved. We see that any parties seeking for exemptions from the regime of CSDR should duly justify such exemption, and demonstrate the same level of safety that the current regime allows.

However, such a regime could be considered if it contemplates rightfully as “a CSD operating a DLT SSS (...) to benefit from certain exemptions from CSDR rules that may be difficult to apply in a DLT context” implying the necessity to observe the CSD license requirements to operate such DLT SSS.

In fact, we highlight that the role of CSDs and accounts within CSDs has a high potential to expand, benefitting from the possibilities carried by DLT;

We see as rather positive the reference to technological neutrality, as it allows for both “traditional” and “new” players in the market, regardless of the technology upon which they operate. Notwithstanding, clarification would be welcomed on the one aspect: following the logic of same business, same risk, same rules, we consider that any operator wishing to provide CSD-like services, should hold a CSD license, independently of these services being based on a DLT platform or other. This should be explicitly mentioned in the CSDR. We recall that CSDs are entities of systemic importance and are supportive in this context of a functional approach, where those acting as a CSD should apply and operate under the CSDR framework.

We take this opportunity to support the position taken by the European CSD Association. Although no Level 1 changes of the CSDR text are required,

clarifications to cater for securities-tokens and DLT may need to be considered (in the entire CSD Regulation), notably the acceptance of new types of financial instruments in a CSD, such as securities token, or their recording in a new form.

1. Definition of CSD: Definition is technologically neutral. DLT provides for a number of governance models and can be applied in the context of a CSD. However, a CSD is by definition a legal entity. This allows the designation of liability for the operation of the DLT platform and compliance with the applicable rules (e.g. capital requirements). A platform does not as such qualify as a CSD because it is not (necessarily) a legal person. The private permissioned version of DLT with a centralised validation model, allows for combining the benefits of DLT such as Peer to Peer transaction, same version of truth, resilience and availability with the benefits of centralized governance such as clear accountability, legal certainty, performance, privacy, integrity and security.

2. Definition of SSS: Definition is technology-neutral, no difficulty to apply in a DLT context.

3. Credits and debits: Confirmation is needed that the data recorded on the DLT addresses of the transferor and transferee can be considered as 'credits' and 'debits' within the meaning of CSDR.

Proposal: Clarification can be provided in Recital 11 of the CSDR that data recorded to a blockchain can be considered as 'credits' and 'debits' within the meaning of CSDR. Alternatively, the regulator could produce formal guidance (such as the ESMA Q&As) in this regard.

4. Records as securities account in a CSD:

a. In the context of a DLT platform, participants hold digital addresses (DLT Addresses) on the platform to which the Tokens are recorded. Whether DLT Addresses are capable of constituting 'accounts' within the meaning of the CSDR would benefit from clarification. We believe a distinction will need to be made between account-based DLT and transaction-based DLT (the so-called UTXO (Unspent Transaction Output) model).

b. The DLT Addresses may be located on a distributed ledger and not in the CSD's centralised internal systems. Notwithstanding this, under the structure considered, a CSD would be the operator/governor/gatekeeper of the DLT platform. Whether the DLT Addresses on the platform are capable of being construed as accounts the text of the CSDR stating that the accounts are "provided and maintained by the CSD" would benefit from clarification.

Proposal: Accounts opened with a CSD in the context of existing systems in which securities are recorded in book-entry form are technically also digital in nature and not physical accounts. It would be difficult to see why DLT Addresses would not constitute 'accounts' in the same way as currently provided accounts with the use of other technology. Further, it is envisaged that the CSD – as operator/governor/gatekeeper of the DLT platform – would frame and regulate the rules of the platform and any account-holding

requirements (including any account opening, operation and termination requirements), and would be responsible for the maintenance and security of such accounts (i.e. the DLT Addresses), and potentially also be entitled to be paid a certain fee for this. There is, therefore, a good argument that DLT Addresses on the platform are capable of being construed as accounts “provided and maintained by the CSD”. It would, however, be helpful, if this view could be confirmed by the regulator/policymaker.

5a. Definition of ‘book entry form’: confirmation needed that the data recorded to a DLT ledger would be capable of constituting a ‘book-entry’ within the meaning of the CSDR.

Proposal: Clarification of Recital 11 that data recorded to a blockchain can be considered as a ‘book-entry’ within the meaning of CSDR. Alternatively, the regulator/policymaker could produce formal guidance (such as the ESMA Q&As) in this regard.

5b. Definition of ‘dematerialised form’: Confirmation needed that tokens recorded to a DLT ledger (assuming such tokens constitute ‘financial instruments’ within the meaning of the MiFID) are capable of being construed as financial instruments in ‘dematerialised form’ within the meaning of the CSDR.

Proposal: Tokens that exist purely in digital form on the DLT platform should be no different to the concept of ‘dematerialised securities’ that are issued straight to screen in the context of existing systems. Tokens on a DLT platform are capable of being structured differently, but the DLT platform in this context is envisaged to have the same elements/features as existing dematerialised securities, with the difference simply being that they are issued on a distributed system rather than a centralised one. It would be helpful if this view could be confirmed by the regulator/policymaker.

6. Definition of ‘settlement’: When a transaction is ‘validated’ on a DLT platform, data is recorded to the transferor’s and the transferee’s DLT Addresses that results in a ‘transfer’ of the token. Whether this would meet the requirement to have ‘delivery’ of the securities (in this case, the tokens), such that ‘settlement’ within the meaning of the CSDR occurs at this point, would benefit from clarification.

Proposal: Provided the underlying terms and conditions of the tokens and the contractual arrangement between the members on the DLT platform set out clearly that their obligations to each other would be discharged by this method of transfer, the token transfer mechanism should be capable of resulting in ‘settlement’ within the meaning of the CSDR (subject to any national law requirements in relation to how title can be transferred on an electronic platform or register maintained by a third-party operator). It would be helpful if this view could be confirmed by the regulator/policymaker.

7. Delivery versus Payment (DvP) considerations: DvP on a DLT network could be achieved on a single DLT network by making the cash transfers directly on the DLT ledger. These could be done through Central Bank Digital

Currency (CBDC) or with asset-referenced tokens or e-money tokens (which we assume would be considered commercial bank money). Alternatively, cash can be processed outside the DLT network ('off-ledger') through mechanisms of interfaced settlement between the DLT network and the cash payment system. New technologies would allow for such interfaced settlements to be conducted in a 'simultaneous and irrevocable' manner if both the DLT network and the cash payment network are governed by regulated market infrastructures or central banks.

If settlement is not done in central bank money (in this case, CBDC), it is unclear how the current CSDR requirements for the provision of banking-type of ancillary services and settlement in commercial bank money would apply to asset-referenced tokens or e-money tokens that are used as settlement asset. Indeed, the settlement asset should carry as little credit or liquidity risk as possible. As it will be crucial for the development of DLT that a tokenized form of cash (CBDCs or asset-referenced tokens/e-money tokens) can be used for the DvP settlement of securities, the review of CSDR should aim to clarify the requirements linked to DvP settlement in central bank money and commercial bank money related to cash tokens.

8. Settlement internalisers: Under the Pilot Regime proposal, DLT multilateral trading facilities (MTFs) can obtain an exemption from Article 3 (2) of the CSDR. Consequently, they can perform CSD services (such as securities settlement) without being licensed as a CSD. Since only a duly licensed CSD can operate an SSS as designated in accordance with the SFD, the settlement system of such DLT MTF does not qualify as an SSS under the SFD. The DLT MTF is, therefore, a settlement internaliser. Given the legal consequences of such qualification under the SFD, we believe that a confirmation would be appropriate.

As the pilot regime and the Markets in Crypto-assets (MiCA) Regulation serve the larger purpose of the digital financial package it should be ensured that there is no conflict of interest between the different initiatives within the package in total. One goal of the digital financial package is to integrate markets in the spirit of a European capital market union. We have seen the negative impacts of fragmented markets and resulting inefficiencies which yet resulted mainly out of different national regulations and business connectivity. With opening up securities registration and settlement services for multiple providers based on a heterogenic technology with lots of different protocols and implementation there is a new kind of risk for a harmonized European capital market which is technical fragmentation. For that reason, there is a need for high standards regarding running market infrastructure and connectivity in a technical sense.

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

From our perspective, most concerns with applying the current rules in a DLT environment do not originate from the current regulatory framework itself but are technology specific and inherent.

Therefore, we think that rather "classic" risks of any new asset-class, e.g.

fraud, money laundering or market manipulation can be addressed with existing rules and procedures. However, technology related "new" risks arise as well, e.g., finality, integrity of the network, „forks“, „whales“, „right to be forgotten“ in Art 17 General Data Protection Regulation (GDPR), which must also be addressed accordingly.

Further, in order to tackle the IT security dimension, we think it is necessary that financial service providers which use this new technology should follow the same security standards as other financial entities, which will be foreseen in the current legislative proposal of the European Commission on digital operational resilience for the financial sector ("DORA").

A so called "trusted third party" could help to prevent or mitigate such risks of unintended programming of the algorithm from occurring. Any standards set in this context should be defined at the EU level, but should be aligned with international bodies and developed with market participants.

Another challenge could be the fragmentation of EU and already existing Member States rules, covering crypto assets. This becomes especially relevant the latest proposal of the European Commission to amend Annex I Section C of MiFID II, including financial instruments issued by means of DLT into the scope of the directive, which leaves again some aspects to the Member States' discretion.

Furthermore, we take the opportunity to support the views of the European CSD Association in this regard:

1. Rules on settlement periods: T+2 settlement period comes mostly from market practice (for liquidity/clearing purposes) rather than from technological limitations linked to CSDs. Technically, CSDs could operate on a T+0 with their existing technology in a similar way as DLT. For this reason, we do not see why settlement periods should differ based on the technology used. Having different rules on settlement period for DLT would also go against the technology-neutrality principle.

2. Rules on outsourcing of services or activities to a third party: Outsourcing under Article 30 of CSDR: Clarification of the circumstances in which entities involved in the validation process give rise to an outsourcing for the purposes of Article 30 of the CSDR would be welcome.

Proposals:

a. - In our opinion, as long as a **CSD is the only node able to validate a transaction** on the DLT platform, the mere (real-time) **sharing of data** with the participants, and the **validation of changes** to that data (for example, recording any transfer of tokens on the platform) that results in the local copies of the data structure on each participant's node being updated automatically in real-time (the so-called 'distributed record' model), **should not of itself result in or be seen as the CSD outsourcing its obligations in respect of the platform it operates** (assuming the validation and recording of transactions on the platform remains exclusively the power of the CSD). This view should be confirmed by the regulator.

b. - As opposed to the 'distributed record' model, **the 'distributed validation' model** consists of the participants in the network (or a subset of

them) running validator nodes that share the function of validating transfers and maintaining the ledger, in accordance with the system protocol, with controls built-in at the level of the central operator (CSD). It has to be clarified **how the CSDR outsourcing requirements would apply** to this model. Is this the outsourcing of a core service? A key drawback of the outsourcing approach is that it would not really reflect the practical realities. Distribution is not the same as a typical outsourcing arrangement. Outsourcing suggests the service provider is structurally subordinated to the operator while distribution involves the operator and the other participants mutually performing a function for and to each other. As a result, the concepts and obligations under the existing regulatory framework may not naturally sit well. For example: (i) outsourcing is not allowed to prevent the exercise of supervisory and oversight functions, including on-site access to acquire any relevant information needed to fulfil those functions, but it is difficult to see how this should be applied in practice; (ii) under the outsourcing regime, the CSD would maintain full regulatory responsibility. This again emphasizes that an appropriate liability framework is required to allocate liability between the system operator and the validator nodes, so as not to expose the system operator to excessive liability risk.

Rules on communication procedures with market participants and other market infrastructures

Definition of 'international open communication procedures and standards' under Article 35: it may be beneficial to have the clarification that, for example, the DLT-based real-time data-sharing with nodes would satisfy this requirement in the CSDR.

Proposal: Clarification of recital 41 that DLT-based communication methods to share information on a real-time basis would satisfy this requirement. DLT is still developing and may be seen as not being standardised in that sense. In alternative to a recital, the regulator could produce formal guidance (such as the ESMA Q&As) in this regard.

Rules on the protection of securities of participants and those of their clients: See comment on segregation in question 18.3.

Rules regarding the integrity of the issue and appropriate reconciliation measures: Reconciliation measures under Article 37 (1): Confirmation that reconciliation can be satisfied through real-time data sharing on DLT would be beneficial.

Proposal: The reconciliation requirement requires appropriate measures to achieve a certain outcome. To the extent real-time data sharing achieves this specific outcome, this requirement should be capable of being satisfied without further steps to be taken. It would, however, be helpful if this view could be confirmed by the regulator/policymaker.

5. Rules on cash settlement: See question 18.1 DvP considerations.

As mentioned, if settlement is not done in central bank money (in this case, CBDC), it is unclear how the current CSDR requirements for the provision of

banking-type of ancillary services and settlement in commercial bank money would apply to asset-referenced tokens or e-money tokens which are used as settlement asset. Indeed, the settlement asset should carry as little credit or liquidity risk as possible. As it will be crucial for the development of DLT that a tokenized form of cash (CBDCs or asset-referenced tokens/e-money tokens) can be used for the DvP settlement of securities, the review of CSDR should aim to clarify the requirements linked to DvP settlement in central bank money and commercial bank money related to cash tokens.

6. Rules on legal risks, in particular as regards enforceability: Requirements are clear and should also be complied with in a DLT context. However, we believe the EU authorities should clarify to what extent the existing legal framework is applicable to transactions in securities tokens on DLT. The lack of legal certainty in many EU jurisdictions; makes it a challenge for a CSD to comply with the CSDR requirement to design its rules, procedures and contracts in such a way that they are enforceable in all relevant jurisdictions (including in the case of the default of a participant). The clarifications in CSDR mentioned above would be a first step, together with the proposed amendment of the definition of financial instruments in MiFID.

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

1. Buy-ins should be mandatory?
2. Buy-ins should be voluntary?

➤ Voluntary buy-in process has proven to be inefficient

Prior to the CSDR SDR, buy-ins were commonly included in bilateral contracts. In theory, these bilateral agreements guarantee that fails will be solved via buy-ins voluntarily initiated by the receiving party. This process aims to protect the buyer and ensures ultimate delivery.

However, reality has shown that "self-regulation" has not worked out and voluntary buy-ins are generally not utilised. Market participants do not initiate buy-ins in order to not harm the business relationship with the failing counterparty, often a major broker or bank. The fear of damaging relationships and the dominance of major sell side participants effectively neutralize voluntary bilateral contractual arrangements. As a result, we see relatively high non-delivery rates, whereby associated risks and costs are borne by the investors. In our talks with various market participants the lack of effectiveness of voluntary buy-ins has been repeatedly confirmed.

A mandatory buy-in regime would alleviate the issues of voluntary arrangements and provide proper incentives for all market participants to work towards improved settlement efficiency. As specified in the regulation, this requires robust market standards and neutral buy-in agent entities acting in the best interests of all involved participants. One could argue that if voluntary rules were sufficient, SDR may not have been initiated in the first place.

➤ Most settlement fails happen due to operational deficiencies.

Reducing the cause is possible and will decrease probability of a mandatory buy-in

According to the market participants' feedback, operational deficiencies in back offices are the most common reason for settlement fails, even in liquid instruments. These deficiencies comprise understaffing, fragmented IT infrastructure and systems or highly manual procedures and lack of straight-through-processing. Insufficient operational post-trade capacities may result in incorrect settlement instructions (miscommunication, human error etc.) that cannot be matched by CSDs. In addition, inadequate inventory management and position monitoring further aggravate the issue.

Settlement fails usually happen as a result of interconnected circumstances and not as isolated events. For example, a strategic decision to not deliver a specific security, as well as operational issues may result in a chain of cascading fails.

In the current market environment, there is hardly any direct financial impact of settlement fails on the failing party. Market participants are therefore not incentivized to improve post-trade operations with the aim to increase settlement efficiency. Such improvements could significantly reduce settlement failures and would be a key driver of the SDR success.

It needs to be emphasised that the industry can significantly reduce the number of settlement fails (as outlined above) and respectively the number of mandatory buy-ins by fixing remaining fails in the extension period foreseen by SDR. The residual (low) number of fails that cannot be solved in the extension period are then to be 'bought-in' by independent Buy in Agents. Experience from the clearing universe shows that broad auctions incorporating multiple market participants minimise the impact on both buyer and seller of the original transaction. Consequently, the industry has the possibility to minimize the number of buy-ins by improving post trade operations and to minimise the impact of buy-ins by actively participating in the respective auctions. The industry is therefore fully in control and we question the principle of opposing the SDR. It seems that the strategy is to request continuous delays of SDR coming into force, rather than embrace the rules which would enhance settlement efficiency. Ultimately, increased settlement efficiency would strengthen the financial system.

- Improvements in settlement efficiency already triggered and achieved in preparation for the mandatory buy-in introduction.

The feedback we received over the last years from market participants is that they expect a significant increase in settlement efficiency. Numbers as high as 90% were given whereby mandatory buy-in rules were particularly seen as strong incentive to further improve, automatize and digitize back office procedures. Newly developed IT solutions and post trade services have surfaced, providing improved tools to avoid and manage settlement fails. This is a clear indication that SDR sets the right incentives and should not be further delayed. Indeed, it was repeatedly mentioned that additional delays may cause a roll back on some of those improvement initiatives.

The complex CSD setup in the European Union paired with rather quaint legal repercussions has certainly impacted settlement efficiency, at least in comparison to other jurisdiction such as the US. Again, SDR alleviates this by

providing proper incentives via mandatory buy-ins and settlement fail penalties.

There is clear evidence in the past that rules such as those imposed by SDR can easily be digested by the market. The Short Selling Regulation (SSR) introduced mandatory buy-ins for centrally cleared equity transactions. The market quickly adopted them without significant turbulence and today we see a settlement efficiency on intended settlement date of almost 100% for centrally cleared equity transactions. We expect the same to ultimately hold true for the non-centrally cleared market once the SDR takes effect.

- Post-trade efficiency strengthens the financial market and reduces costs for Retail Investors

Some market participants have pointed out that managing settlement fails nowadays carries significant operational costs. Post-trade departments need to monitor, claim, escalate and often negotiate the various aspect of settlement fails. Those processes are generally highly manual and not standardised. Digitalisation and automation will therefore not only increase settlement efficiency, but also reduce operational costs. As these costs are passed on directly - or indirectly - to investors, we can expect a positive effect on general market efficiency.

- Capital Markets Union

The Capital Markets Union was initiated to harmonize the European Financial Market(s) and improve the financing opportunities for the real economy. Financing of economic growth shall utilize bond markets more heavily thus reducing the dependency on the banking sector. Consequently, this tool of liquidity sourcing should decrease the financing costs. In order to have a trustful financial market, investors, in particular, retail investors, need certainty regarding delivery of their purchases. Otherwise, investors will demand for a risk discount / yield premium, which again leads to higher financing costs. The mandatory buy-in process will foster the trust of retail investors in the financial markets and empower the Capital Markets Union, in line with the objectives of the European Parliament resolution of 8 October 2020 on further development of the Capital Markets Union (CMU)¹. Mandatory settlement discipline rules will particularly protect smaller financial market participants. SDR creates a level playing field, eliminating the previous situation of not initiating buy-ins in order to protect relationships. The ultimate investor / retail investor will equally benefit as he/she will receive the securities in a reasonable timeframe without facing excessive costs.

It can be assumed due to the size of the transactions and the type of the instruments (small-cap equity / exotic equity / Exchange Traded Funds (ETFs)) that retail investors are often on the purchasing side and suffer from

¹ European Parliament resolution of 8 October 2020 on further development of the Capital Markets Union (CMU): improving access to capital market finance, in particular by SMEs, and further enabling retail investor participation (2020/2036(INI)), para. A and B.

non-delivery of an institutional seller (Bank, Market Maker), which is hesitant to cover its short sale due to relative high efforts (e.g. by Borrowing shares) compared to the small size.

Only a standardized and harmonized settlement discipline regime would 1) set the right incentives that the Bank/Market Maker sells only shares it can deliver and 2) protect the retail investor from loss of its investor rights and share price performance.

3. Rules on buy-ins should be differentiated, considering different markets, instruments and transaction types?

We agree that rules should be differentiated considering different markets, instruments and transaction types. This is already reflected in the current Level 2 text. For more details please see Question 36.

4. Should a pass on mechanism be introduced?

Deutsche Boerse supports the effort and recognises the benefits of such a mechanism.

Nevertheless, settlement fail chains can be avoided by improving operational processes within back offices and, when they do occur, can still be addressed by the counterparties within the foreseen extension periods. A buy-in agent in his/her role of an independent third party can support the consolidation of the settlement fail chain data and ensure communication between the different buy-in agents in order to identify those fail chains (even if more than one buy-in agent is involved). This could facilitate the mitigation of the “domino effect” within the mandatory buy-in process.

5. Should the rules on the use of buy-in agents be amended?

We believe that the buy-in agent should be a neutral party in the market without a conflict of interest. This ensures fair treatment towards all involved stakeholders.

A buy-in agent shall not hold own positions in securities it sells to the party which triggered the buy-in. From our perspective, a buy-in agent should not be incentivised to make a profit out of the difference between purchase and sale of the bought-in securities.

Other special infrastructure providers such as CSDs, CCPs and Trading Venues shall not be used as buy-in agents, as their primary business activity may be conflicting with the neutrality required for a buy-in agent.

The buy-in process, if done through an auction process, ensures competition between the liquidity providers and is open to any party who can sell securities under a mandatory buy-in trading and settlement requirement (same-day guaranteed delivery). The buy-in agent selects the best available price out of the price offers received. Price caps per asset ensure that the execution price is not inadequately high and kept within reasonable boundaries.

Buy-in agents execute buy-ins in an exceptional environment. In light of a special situation where a settlement had already failed for 4 or 7 or 15 days, the buy-in agent should use non-typical settlement windows (t+0) and oblige the party providing the liquidity to guaranteed same-day delivery of the

bought-in securities. The execution of the buy-in may be conducted by the buy-in agent in a special auction outside of a regular market (exchange, MTF, etc - where there is no guarantee of delivery).

The Level 1 and Level 2 text already provide a good basis for the buy-in agents to offer their services. The details, as outlined above, are not necessarily required to be prescribed by the regulation and should be subject to best market practices and procedures.

6. Should the scope of the buy-in regime and the exemptions applicable be clarified?

We agree that technical details should be further elaborated by ESMA via Q&As in order to set a commonly known ruleset and conduct. Level 1 and Level 2 text (as it is) already provides a good basis and sufficient clarity.

Further, we refer to our requests for clarification already shared with ESMA, covering:

- Scope of financial instruments relevant for Buy-ins

We would appreciate a dedicated list published by ESMA with all financial instruments that are subject to the Buy-in rules. The scope of financial instruments potentially subject to a buy-in process is not clearly defined. Although it is assumed market practise that instruments listed in the ESMA 'FIRDS' database are the basis and that instruments listed in the database 'Exempted Shares under Short Selling Legal Framework' are excluded, a clarification by the EC that this assumption is correct (or if not, what the correct scope definition is) would increase certainty for market participants. A dedicated list in addition would ease the operational handling for the selection of relevant transactions.

- Start of buy-in process.

For the purpose of harmonisation of the buy-in process, it should be clarified that the buy-in process can be initiated immediately after settlement cut-off time on the last day of the extension period.

- Portfolio Transfers, Central Bank Operations, Gifts & Inheritances.

It should be clarified that securities transactions should be excluded from the buy-in process:

- 1) where there is no change of beneficial ownership, such as realignments between own accounts
- 2) non-delivered collateral to a central bank
- 3) securities transactions based on Gifts and Inheritances between retail investors

- Primary Market transaction

Primary Market transactions for Bonds, Equities, ETFs and other Funds are related to the initial issuance of a financial instrument, where the new instruments are booked into the CSD or ICSD account of the Issuing entity or the underwriting banks. We would support a clarification that the initial electronic book-entry into the CSD or ICSD account should be exempted from the buy-in. The finalization of this initial issuance depends on conditions that

are usually not related to the settlement discipline of a Trading Participant, but on technical and legal issuance procedures, such as the completion of a prospectus or the static data set up in the CSD’s technical infrastructure. However, in our opinion, all other settlements taking place after the initial issuance, i.e. settlement between the CSD account of the issuer or the underwriting banks and an investor or any other intermediary, should be treated in accordance with the standard buy-in regime. For the avoidance of doubt, we believe that trading activities of an asset manager (buying of securities for an Undertakings for the Collective Investment in Transferable Securities (UCITS) or Alternative Investment Funds (AIF)) should not be considered as primary market transactions, unless the purchase concerns newly issued Fund/ETF shares.

7. Should the asymmetry in the reimbursement for changes in market prices be eliminated?

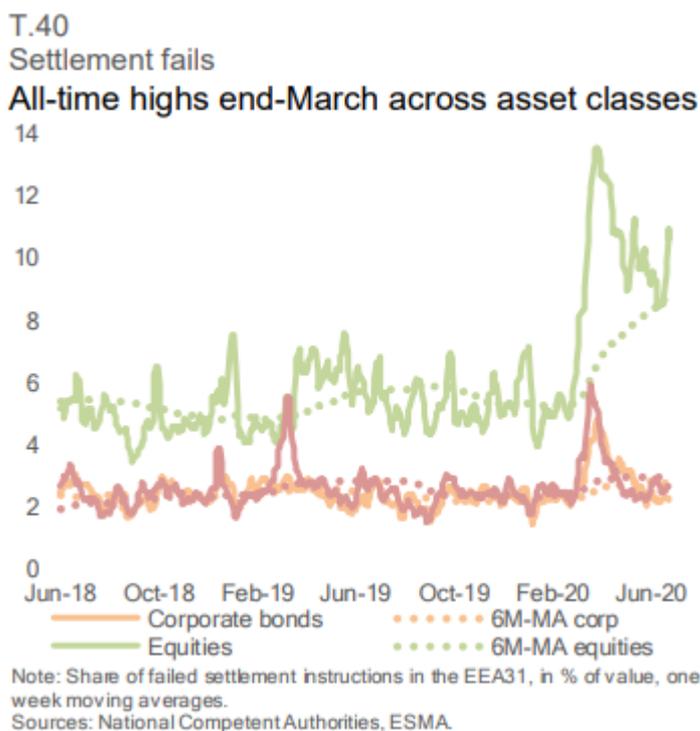
Deutsche Boerse recognises the possible advantages and disadvantages of the asymmetry in the reimbursement for changes in market prices. Given the lack of evidence, we believe that an analysis could be performed after the go-live of the existing ruleset to support the decision-making on whether the asymmetry should be eliminated or not.

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.

- Statistical evidence on the COVID-19 crisis impact on settlement efficiency

Data evidence from ESMA² (see T.40) shows the spikes in failures to deliver in March 2020, in line with increased trading activity in the midst of the COVID-19 crisis.

On the contrary to industry concerns, ESMA reports that “most settlement fails were resolved between one and five days after the intended settlement

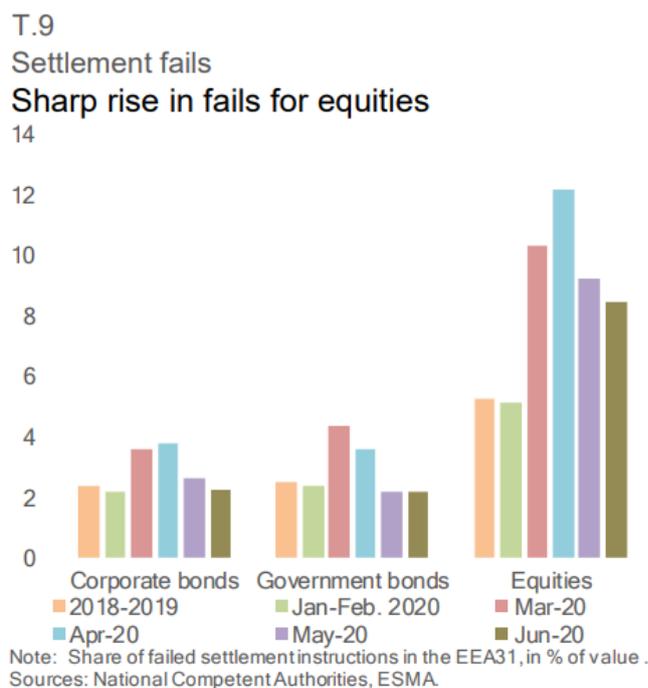


date” (see page 24, [ESMA report on trends, risks and vulnerabilities](#)). Considering the extension periods outlined in the SDR (4-7 days for most of securities and 15 days for rare cases), the vast majority of failed settlements would likely not enter the mandatory buy-in. This shows that current extension periods are calibrated accurately and seem to be fit-for-purpose even in a crisis scenario with increased levels of settlement fails. Any call that the SDR regime would have caused further stress on the financial system in the COVID-19 crisis is not supported by the evidence given. Constant repetition does not change the facts.

Further data evidence from ESMA shows that during the crisis in March-April 2020 there had been a sharp increase in failed settlements within the equities universe that persisted until June 2020 whereas the bond market experienced only a mild spike and quickly returned to pre-crisis levels. This is in line with the observation during normal market conditions. Failures to deliver are generally more prominent in equities and are relatively low for corporate and government bonds.

One of the key arguments against the regime is that financing costs for the real economy and the financial sector will grow dramatically with the introduction of the mandatory buy-in requirement. Considering that bonds generally exhibit relatively high settlement efficiency and most failed settlements would have been resolved prior to the triggering of the buy-in process, the argument seems hollow.

Moreover, one must note that for corporate bonds, a spike in settlement fails similar to the March 2020 level occurred also around March 2019 (see T.40, [ESMA report on trends, risks and vulnerabilities](#)). This indicates that fail rates for corporate bonds may be influenced by other factors than the COVID-19 crisis.



We have also conducted an analysis based on real trade data provided by

medium/large-sized financial institutions. Our results are in line with the ESMA report (see T.9 and T.40, [ESMA report on trends, risks and vulnerabilities](#)) and show, that 80% of the buy-ins – if the SDR were already in place in 2020 – would have occurred in equity-style instruments (incl. ETFs, Funds, Certificates) with a transaction size of less than EUR 250,000. Also, only 17% of the buy-ins would have been in corporate bonds out of which approx. 60% have a transaction size of less than EUR 250,000. Government bonds play only a minor role (less than 0.6% with size of more than EUR 15m). The analysis confirms that the corporate bond market is less affected by the SDR and that there is no risk of serious negative impact with regards to the financing of the economy. It also shows that there is a need for a mandatory buy-in regime, in particular for equity and ETF instruments, to protect retail investors.

The potentially negative impact of the SDR should not be overestimated considering the lack of data evidence. It rather should be embraced as an enabler to tackle operational process deficiencies.

➤ Widening of the bid-ask spread

The industry currently emphasises a direct link between the mandatory buy-in and widening of the bid-ask spread, in particular with respect to bond markets in times of crisis. The concern is that intermediaries like market makers will demand a risk premium, thus increasing the bid-ask spread. Assuming that market participants ultimately pay this bid-ask spread, the financing costs for the economy would indirectly increase.

As outlined above, only a portion of failed settlements will lead to mandatory buy-ins. Whereby the likelihood of a settlement fail will greatly depend on the specific instrument traded. Intermediaries like market makers should reflect this in their pricing mechanism and as a result may adjust bid-ask spreads accordingly. Liquidity in instruments that carry only a small chance for settlement fails should not be affected at all (bid-ask spread unchanged); liquidity in instruments carrying very high settlement risk should properly reflect that risk (wider bid-ask spread). This would create the level of transparency missing today. The implied costs of high settlement fail risk is currently hidden and ultimately borne by investors. Too tight bid-ask spreads may mislead investors into making costly mistakes. We expect that market makers will be able to improve sourcing and will continue to act competitively thus minimising a potential negative effect here. If anything, increased transparency improves market efficiency.

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

The Settlement Discipline Regime and the buy-in requirements are key elements of the CSDR to avoid settlement fails, which can have significant repercussions on market trust and stability. In particular, the mandatory nature of the buy-in requirements is a key aspect of the rules to ensure a

consistent up-take of such back-office procedures and avoid penalizing market participants who do so on a voluntary basis. The core elements of the Settlement Discipline Regime should remain untouched as substantial efforts and investments have already taken place.

With regard to penalties, we believe that the CSD settlement fails monitoring/ reporting and the pending ESMA Guidelines pose no fundamental issues, but we consider various reporting obligations to be a burden:

- SDR RTS Art. 19 (re. CCP transactions): in line with all stakeholders, we support to remove the requirements and apply Art. 17 instead;
- Usage of MiFID/R ESMA databases FIRDS, Financial Instruments Transparency System (FITRS), Short selling regulation exemption list: not fit for penalty purposes/ daily processing by CSDs, daily technical issues faced;
- Pending ESMA/ European Commission feedback on fundamental questions: Investment Funds redemptions/ subscriptions, primary market activities in/ out of scope?

There might be room for some fine-tuning enhancements mostly at L2 which could allow for a better delivery of its tools, namely in the context of SDR and the buy-in regime.

All settlement instructions generated to reflect primary market trades (subscription, redemption and switches) should be out of scope of the settlement discipline regime. Also, we think that any movements generated to reflect a change in Transfer Agent books for Funds should be set out of scope (such as transfers). For domestic markets, we might need to agree with all stakeholders on an easy way to identify those instructions across CSDs.

Secondary markets trades should, in our view, be in scope of the settlement discipline. This statement also applies to ETFs. We need the regulator to clarify these points and distinguish ETFs from other funds if required.

We would only highlight that some Q&As have not been timely enough to allow for all SDR requirements implementation.

1. Calibration and granularity of extension periods:

In our view the extension period is the main tool that can be used to steer the impact of the SDR buy-in regime on the industry.

In general, the SDR, as outlined in Level 2 text, seems appropriate to address settlement fails. In addition, we want to repeat that solutions exist to avoid settlement fails. The failing counterparty can take mitigating actions within the extension period in order to prevent the mandatory buy-in. As outlined before, the extension periods set by the Level 2 text were sufficient in times of stress (COVID-19 crisis) and seem to be adequately calibrated.

Nevertheless, further granularity within the extension periods could be considered, particularly for corporate and government bonds. To reflect the difference in liquidity of these instruments, the extension period for the corporate bonds could be increased to 15 days (shift to the small- and medium-sized enterprise (SME) growth market bucket), whereas for

government bonds (due to higher liquidity) the extension period could stay as is (7 days).

2. Complementary character of cash penalties and mandatory buy ins:

In the last weeks, industry representatives and associations have proposed to go live with the cash penalties first and with the mandatory buy-ins later. We want to emphasise that from our perspective, cash penalties and mandatory buy ins are complementary tools to increase the settlement efficiency. If cash penalties are not accompanied by mandatory buy ins, settlement fails can remain open until infinity unless there is a clearly specified time limitation when they are either cancelled or solved.

If there is a time limitation, the delivering counterparty has an option (by law) not to deliver if it considers it favourable to pay cash penalties for a certain period of time instead of delivering the sold security. This optionality will have a pay-out structure similar to some derivatives and may lead to aggressive trading strategies not inline the original intent to sell a security. This is potentially harming the interest of the receiving party.

We want to make clear that, from our perspective, the split of cash penalties and mandatory buy ins contradicts the original idea of SDR and endangers the desired outcome.

3. Buy-in: CCP as receiving party, no onwards obligation to receiving clearing member:

For the purpose of buy-ins, CCPs are the receiving party and no onwards obligation should apply to clearing members. A clearing member can fail to deliver to a CCP as the receiving party and this may result in the CCP executing a buy-in. No linkage exists between a specific fail to a CCP and any specific delivery or deliveries from a CCP. The buy-in does not change the outstanding delivery obligations of the CCP to its receiving clearing members. Once a CCP has received securities through a buy-in they will be delivered to waiting receiving clearing members through the normal settlement process. Therefore, receiving clearing members need not and should not be referenced in Articles describing a CCP buying-in a failing delivering clearing member.

4. CSDR relevant classification of instruments: Clarification for the processing of instruments with lack of CSDR relevant classification qualities common mandatory CSDR database for instrument classification:

Instruments with lack of CSDR relevant classification qualities/common mandatory CSDR database for instrument classification. For Buy-ins, instrument qualifiers for example "CSDR relevance" and "liquidity indicator" are preconditions to correctly process the buy-in schedule (e.g. exemption period) triggered by counterparties and CCPs. These qualifiers are not accessible in a common database that is also aligned and in sync across all markets. Existing databases already show lack of information, which has to

be added to/interpreted by counterparties for Buy-in application. Enhanced data quality and clear rules for lack of information are required to apply buy-ins compliant to CSDR rules.

Question 43: What other topics not covered by the questions above do you consider should be addressed in the CSDR review (e.g. are there other substantive barriers to competition in relation to CSD services which are not referred to in the above sections? Is there a need for further measures to limit the impact on taxpayers of the failure of CSDs)

In order to complement the messages outlined above, we would point out a few items that would allow CSDs to contribute more efficiently to CMU and to increase the EU's sovereignty. These points can be analysed in two dimensions: intra-EU and Global.

Intra-EU dimension:

Further harmonisation in the areas of tax-related matters, insolvency laws, and securities laws would be key steps towards the Genuine Single Market. We take the opportunity to fully endorse the views of the European CSD Association in this regard.

Furthermore, more convergence could be achieved amongst NCAs, if there were improved alignment between CSDR and other financial legislation. CSDR is an institutional legislation and is the prime legislative framework for CSDs. Nevertheless, CSDR co-exists with other financial legislation, and this should be acknowledged in CSDR, as well as the way in which these other legal instruments influence (or not) the CSD regime. We believe this most relevant for Alternative Investment Fund Managers Directive (AIFMD)/UCITS and CRD/CRR:

Regarding the interaction between AIFMD/UCITS and CSDR - CSDs and fund depositary banks have different structures as they play a different role and serve different purposes under different regulatory frameworks. CSDs do not act as fund depositary banks and do not take the same risks. We note the current grey zone when it comes to the delegation of custody to an investor CSD and ESMA's suggestion on a harmonized liability regime in the context of CSDR. In our view, the current liability provisions under national law are sufficient and adequate. CSDR would benefit from including a statement to indicate that [...] [depositary protection rules are covered by CSDR]

Regarding the consolidated supervision in CRD and certain provisions in CRR
- This will apply to CSDs that are part of a group in which there is a banking-licensed entity. We would see benefit in a more explicit acknowledgment of such co-existence, for example by including a reference in CSDR L1. This will enhance convergence amongst NCAs on topics that are not solely guided by CSDR (for example group management, conflict of interest, ...). CSD consolidation needs allow for group-of-CSDs synergies and outsourcing (please see above, in question box 5).

Europe has still key opportunities to seize. Pivotal umbrella initiatives, such as the Capital Markets Union or the International Role of the Euro, will make significant progress in the months to come, and we will also see changes in some central legislation such as CSDR and/or MiFID II/ MiFIR. We recall in this context that the capital markets that the EU (I)CSDs serve can deliver great structural benefits to the EU, both *intra-* and *extra-muros*:

- Increase financial stability by providing a diversified range of highly regulated FMI providers;
- Increase investor protection via stringent rules and regulations governing its FMI services;
- Actively facilitate transformational challenges (sustainability, digitalisation);
- Boost the pandemic recovery, as EU CSDs systems are successfully used for the Support to mitigate Unemployment Risks in an Emergency (SURE) bond issuance.

Ultimately, these actions are catalysts to enhance competitiveness and attract global capital and investments. This leads us to:

Global dimension

From an International perspective, the CSDR review provides an opportunity to European legislators to address concerns relating to the ICSD framework legislation. A balanced review of CSDR along the Capital Markets Union goals will reinforce the resilience and competitiveness of EU Financial Market Infrastructures (FMIs), allowing these entities to contribute to the EU27's sovereignty at a global scale.

2021 will be a decisive year for the EU to make progress on capital markets-related priorities.

In light of the heavy pressure on public finances and a comparatively weak banking system, against the background of the UK withdrawal of the EU and the overall global pressure vis-à-vis the US and Asia, the EU27 faces a serious challenge in redefining its financial services landscape. Without a more strategic approach to promote and protect the EU27's interests, the international dynamics might change with a clear disadvantage against the EU, in favour of its counterparties across the Atlantic. In fact, the reality around the EU27's capital markets remains concerning – see key topics:

- Declining weight of the EU27 in the world economy with GDP growth of 1.5% in 2019 (US: 2.3%; China 6.1%), accelerated by the economic slowdown in 2020 due to the pandemic (sharp drop in GDP of 12.1% in the Euro Area and 11.9% in the EU).
- Structural underdevelopment and fragmentation of EU capital markets has not improved over the past 10 years. For example, market capitalization as a percentage of GDP (2018) is 53% in the EU, compared to 148% in the US, 106% in Japan and 88% in Australia.

- EU infrastructure providers have not kept up in growth in international comparison: European exchanges (Deutsche Boerse Group, Euronext) rank #5 and #11 respectively in terms of market capitalization in Sep. 2020, while exchanges outside the EU continue to expand.
- In addition, there is a long-standing trend towards shrinking IPO markets in the EU. While there was an annual average of 380 IPOs from 1997 to 2007, the annual average from 2008 to 2018 was only 220 IPOs (US: 179; China 350).
- The average equity share trading from 2010 to 2019 was 17% for Europe Middle East and Africa (EMEA), 50% for the Americas and 33% for Asia Pacific (APAC), while the average number of trades from 2012 to 2020 was 9% for EMEA, 30% for the Americas and 61% for APAC.

In a nutshell:

The fact that in Europe the issuance in some currencies implies extremely stringent rules makes the EU market extremely unattractive for possible investors and issuers, and puts us at a competitive disadvantage when compared to other global markets, particularly considering that EU CSDs are subject to far more stringent requirements than they are in most Financial Markets.

EU FMIs are part of the CMU solution, not part of the problem - CSDs have been permanent supporters of further harmonisation and improvement. Measures should be taken to leverage more on these infrastructures at EU and global level, opening doors to its service provision, removing internal barriers—to ensure that the EU CSDs position themselves as key international players and the EU market attractiveness remains a “first by choice” for investors.”