2 February 2021

London Stock Exchange Group response on EC Review of Regulation on improving the securities settlement in the European Union and on Central Securities Depositories

Introduction

The London Stock Exchange Group ("LSEG") is a financial market infrastructure provider, headquartered in London, with significant operations in Europe, North America and Asia. Its diversified global business focuses on capital formation, intellectual property and risk and balance sheet management. LSEG operates an open access model, offering choice and partnership to customers across all of its businesses.

LSEG operates multiple clearing houses. It has majority ownership of the multi-asset global CCP operator, LCH Group ("LCH"). LCH has two licensed CCP subsidiaries – LCH Ltd in the UK and LCH S.A. in France. Both are leading multi-asset class and international clearing houses, serving major international exchanges and platforms as well as a range of OTC markets. They clear a broad range of asset classes, including securities, exchange-traded derivatives, commodities, foreign exchange derivatives, interest rate swaps, credit default swaps and euro, sterling and US dollar denominated bonds and repos.

In addition, LSEG, whilst in the process of divesting the Borsa Italiana Group, it continues to operate Cassa di Compensazione e Garanzia S.p.A. ("CC&G"), the Italian clearing house, providing clearing services for a range of European securities as well as exchange traded equity and commodities derivatives as well as Monte Titoli S.p.A, the Italian Central Securities Depository offering settlement services, therefore, this response also includes views and recommendations of the above-mentioned Group entities.

Introductory remarks

LSEG welcomes the opportunity to comment on European Commission's ("EC") Review of Regulation on improving the securities settlement in the European Union and on Central Securities Depositories ("CSDR"). We would like to make the following key observations:

- CSD Review & Evaluation ("R&E") process should be streamlined to remove uncertainties and harmonise requests for information throughout this process.
- The cross-border provision of services in the EU could be significantly improved provided that the concept of "corporate or similar law under which securities are constituted" is further developed and harmonized to ensure CSDs are able to process securities in their systems according to the applicable law.
- The collection and distribution of penalty fees could be significantly simplified across the market by removing unnecessary duplicative processes the regulation has introduced for CCPs, leaving a single consistent process to be operated by the CSDs.
- CCPs should not incur unintended losses from the calculation, collection and distribution of penalties.
- Any special treatment of SME securities should be based on the instrument rather than the place of trade.
- The revised regulation should address operational complexities arising from implementing CSDR's Settlement Discipline Regime ("SDR") to triparty transactions and collateral transfers.
- Finally, we believe that the implementation date of February 2022 needs to be further considered to provide adequate time for market participants to implement and test all revised regulatory requirements which result from this review.

Below we discuss in greater detail areas which in our view require further consideration/adaptation in the revised text. Where possible we have also provided for specific recommendations to the Level 1 text. Furthermore, for points not covered in the context of the present response, we would refer to the contents of the European Industry of Clearing Houses (EACH) industry response which we support.

1. CSD AUTHORISATION & REVIEW AND EVALUATION PROCESSES

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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.

Monte Titoli S.p.A. has been granted with CSD-R licence in 2019. Overall, the authorisation process has been an opportunity for Monte Titoli to review and improve the efficiency of some operational and organizational procedures. In addition, having a harmonised EU licence strengthens our role as European market infrastructure. Nevertheless, it should be recognised that the authorisation process has produced significant administrative burdens and costs due to the huge amount of information, documents and resources that have been devoted to it from CSDs. We are concerned that these efforts and costs might become recurrent under the Review and Evaluation process ("R&E"), due to the fact that some CSD-R requirements are too wide in scope or leave room for different interpretations by different National Competent Authorities ("NCAs"), thus altering the level playing field amongst CSDs. Therefore, we recommend the European Commission to reconsider the approach embedded in Level 1 and 2 R&E provisions in order to clarify and streamline the process as in our responses to questions 3 and 3.1.

It is important to understand that the length of the authorisation process depends on the complexity of the CSDs' businesses and the high level of requirements of the CSD Regulation and additional local may affect the process in different markets.

Question 3. Concerning the annual review process, should its frequency be amended?

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

Question 3.1 If you responded yes to question 3, what should be the frequency of such reviews?

- Once every two years
- Once every three years
- At the discretion of NCAs

Question 3.1. Please explain your answer to Question 3, providing where possible quantitative evidence and/or examples.

As referred in our response under Q1.1, we are concerned that given the broad scope of R&E requirements and potential different interpretations, this process would led to a duplication of work with the ongoing supervision and ultimately to an unequal level playing field across CSDs.

<u>**Recommendation**</u>: We would suggest:

- **Targeting and Clarifying the scope and objective** of R&E by amending Level 1 provisions: to avoid

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uncertainty that might result in different interpretation / supervisory practices.

- **Review/Extend the frequency** of R&E by amending Level 1 provisions: to avoid the duplication with the ongoing supervision by NCAs we suggest either: (i) to consider R&E requirements already satisfied with ongoing supervisory activities, similar to what exists in the banking world; or (ii) extend the frequency of R&E process to three-year basis.

- **Simplify Information Requirements of R&E:** the content of the R&E process should be the same for all CSDs and should be streamlined so that it does not repeat the entire authorisation process. In particular Articles 41 and 42 of the RTS on CSD authorisation should be reviewed to streamline the R&E process, as described in our responses to questions 4.1, 4.2 and 4.3.

Articles 41 and 42 of Commission Delegated Regulation (EU) 2017/392 prescribe the information and the statistical data that CSDs should provide to NCAs on an annual basis.

Question 4.1 Do you consider this information and statistical data to be relevant for the review and evaluation process described in Article 22 of CSDR?

- Yes, all information and statistical data are relevant.
- No, not all information and statistical data should be required to be provided on an annual basis.
- Don't know / no opinion

Question 4.2 Do you consider these requirements to be proportionate?

- Yes, all information and statistical data must be provided on an annual basis.
- No, not all information and statistical data should be required to be provided on an annual basis.
- Don't know / no opinion

Question 4.3. Please explain your answers to Questions 4.1 and 4.2, providing where possible quantitative evidence and/or examples. If you answered "no" to any of them or to both, please also specify which information and/or statistical data are not relevant or could be provided on a less frequent basis.

First, we note that requests to provide information and statistical data have grown exponentially and have led to a significant increase in costs for CSDs. In this context, would welcome a review of article 41 and 42 of the RTS on CSD authorisation in line with the principle of EC Data strategy for supervisory reporting.

In addition, we would like to point out the following issues with reference to specific information elements of article 42. In particular, we would recommend removing from the list of statistical data *“the mean, median, and mode for the length of time taken to remedy the error, identified according to Article 65(2).”* This is suggested considering that the provision of the data requires a complex computation procedure and the relevance from a supervisory perspective is not clear.

Question 5. Are there specific aspects of the review and evaluation process, other than its frequency and the content of the information and statistical data to be provided by CSDs, that should be examined in the CSDR review?

We support a clarification of the definition for ‘substantial change’ under Article 16 (4) CSDR, as not every change in a CSD should be qualified as ‘substantial’. In this regard it should be highlighted that CSDs have a very low compliance risk appetite, therefore they tend to adopt a conservative approach and report almost every any change to the supervisory authorities. This implies a significant administrative burden both for the CSDs and for the competent authorities, which may ultimately hinder the supervisory activities.

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Question 6. Do you think that the cooperation among all authorities (NCAs and Relevant Authorities) involved in the authorisation, review and evaluation of CSDs could be enhanced (e.g. through colleges)?

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

Question 6.1 Please explain your answer to Question 6 providing, where possible, quantitative evidence and/or examples.

We believe that ESMA and EBA could play a central role for the convergence of supervisory practices. In addition, the peer reviews could increase cooperation among supervisory authorities as it supports information sharing. To the contrary, supervisory colleges may introduce additional complexity without fully addressing the need for convergence.

2. CROSS-BORDER PROVISION OF SERVICES IN THE EU

Question 9. Question for issuers/CSDs – are there aspects of CSDR that would merit clarification in order to improve the provision of notary/issuance, central maintenance and settlement services across the borders within the Union?

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

Question 9.1: Please explain your answer to Question 9, providing where possible quantitative evidence and/or concrete examples.

CSDR provides a framework for the free provision of CSD services, as well as the free issuance of securities, in any EU / EEA Member State. Nevertheless, the rules in CSDR Article 23 – together with divergent application by National Competent Authorities (NCAs) of Article 23 and the closely related Article 49.1 list – have reduced the possibility for CSDs to offer services as Issuer CSDs for instruments issued under the law of another Member State.

Therefore, we believe the following aspects deserve further clarifications.

1) Procedures under article 23

For this purpose, the concept of "corporate or similar law under which securities are constituted" shall be further developed, in order establish an harmonized criteria to be used by Member States to identify which provisions/areas of law are actually relevant for the purpose ensuring that CSDs are able to process securities in their systems according to the applicable law. In this respect, only areas of law and provisions that are relevant for the purpose of CSD activities shall be considered.

Our recommendation is that the list of key relevant provisions in Article. 49(3) is made more transparent and simpler, by specifying exactly which provisions under local law a foreign CSD must comply with. For this purpose, the concept of "corporate or similar law under which securities are constituted" shall be further developed, in order establish harmonized criteria to be used by Member States to identify which provisions/areas of law are actually relevant for the purpose ensuring that CSDs are able to process securities in their systems according to the applicable law. In this respect, only areas of law and provisions that are relevant for the purpose of CSD activities shall be considered.

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In addition, we have observed some divergence in the handling of applications by NCAs. Furthering convergence across the EU would be beneficial. Our recommendation is to have clear guidance and transparency of the process. For example, to ensure a consistent approach, it should be further clarified that, as stated in Article 23(3), CSDs are requested to provide the assessment of the measures to allow its users to comply with the national law "where relevant", meaning only where requirements or impediments that would require specific measures are identified in the key relevant provisions. Indeed, some NCAs have requested CSDs to provide such assessments also in case where no issues have been identified by CSDs in key provisions. Therefore, as stated above, to allow a consistent application of Article 23, it is of utmost importance to harmonize and simplify the key relevant provisions.

2) Divergent interpretation of the meaning of cross-border provision of services.

Under Article 23(2) CSDR, the interpretation of cross-border provision of services is diverging from other pieces of EU legislation, such as MiFID, CRR, CRD. While in these Directives and Regulation the provision of cross-border services is defined by a strategic business choice of the relevant entities to perform and provide services in another jurisdiction, in CSDR this provision of cross-border services seems to be defined by CSDs having securities constituted under the law of another Member State. (In that sense, it is less for a CSD and rather for an issuer to make this decision).

In our view the real cross-border service would be the one that would require the authorisation for its provision in another Member State. It is a legal fiction to consider the provision of notary and central maintenance services as cross-border service provisions, without the establishment of a branch. Indeed, the CSDR notary and central maintenance services cannot be provided but in combination with settlement services by CSD. Hence, the cases covered would be a combination of: (i) establishing a settlement system SSS under the laws of another jurisdiction and (ii) proving either notary service for foreign securities (under Article 49) or the central securities account maintenance service. As the provision of notary and central maintenance for securities issued in another members state certainly does not alter the settlement location in terms of jurisdictions, the passporting requirement should be deemed relevant when both settlement and either notary or central maintenance are provided in another jurisdiction.

Recommendation: We would support a review of the passporting provisions and would further suggest limiting the scope of application of the passporting regime to shares would greatly simplify the whole process of determination of the relevant law for the purposes of Article 23 and ensure only one law (the law of the issuer) and therefore one Host Member State would be brought into the process.

Question 10. Question for CSDs – have you encountered any particular difficulty in the process of obtaining the CSDR "passport" in one or several Member States different to the one of your place of establishment?

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

Question 10.1: If you answered "yes" to Question 10, please explain your answer, providing where possible quantitative evidence and/or concrete examples.

Please refer to our response under Q9

Question 11. Question for CSDs – in how many Member States do you currently serve issuers by making use of your CSDR "passport"?

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[no comment]

Question 12. Question for CSDs – are there any obstacles in the provision of services to issuers in a Member State for which you have obtained the CSDR "passport" that actually prevent you from providing such services?

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

Question 12.1: Please explain your answer to Question 12, providing where possible quantitative evidence and/or concrete examples.

The passporting process has not prevented CSDs from offering issuer-CSD services in the country of establishment of the CSD for securities constituted under the laws of another Member State. However, administrative and legal costs and complexity have disincentivised CSDs in filing for a CSDR passport.

Question 13. Do you think that the cooperation amongst NCAs would be improved if colleges were established for [or cooperative arrangements were always involved in] the Article 23 process?

- Yes
- No
- Don't know / No opinion

Question 13.1: Please explain your answer to Question 13, providing where possible quantitative evidence and/or concrete examples.

We believe that there is a need to strengthen supervisory convergence. In particular, the process under Article 23 should be more transparent and the information required by each competent authority standardised.

Question 14: How do you think ESMA's role could be enhanced in order to ensure supervisory convergence in the supervision of CSDs that provide their services on a cross-border basis within tHe EU?

[no comment]

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 from 1 to 5.

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	1 (Not a concern)	2 (Rather not a concern)	3 (Neutral)	4 (Rather a concern)	5 (Strong concern)	No opinion
1. 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))	X					
2. Definition of 'securities settlement system' and whether a blockchain/DLT platform can be qualified as a SSS under the SFD	X					
3. 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;	X					
4. 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)	X					
5. Definition of 'book entry form' and 'dematerialised form'	X					
6.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.	X					

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7. 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)	X					
8. What entity could qualify as a settlement internaliser, that executes transfer orders other than through an SSS	X					

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

In our view, the CSDR is already a technology-neutral legislation, as some CSDs experiment or use the technology in their activities. However, we see a benefit in including in CSDR recitals some clarification in terms of the compatibility of certain CSDR with DLT. This would enhance certainty and ensure consistent interpretation of EU regulation across Member States also in view of the application of the future Pilot Regime. Indeed, we see merit in providing explanation on how terms and concept used in CSDR e.g. book-entry, accounts etc. are construed under European Law according technology neutrality principle so that they can be easily adapted to a DLT context.

At the same time, it should be recognised that since concepts like “book-entry form”, “accounts” etc. are in the substance governed by national securities law there is a need to foster further convergence by Member States on this matters and therefore we would encourage European Commission to promote convergence initiatives in this regard to avoid fragmentation across the market.

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 / not relevant

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

[no comment]

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

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Question 19.1. Please explain your answer to question 19.

Book-entry requirements under CSDR are digital in nature and not physical, so it is difficult to imagine why DLT addresses would not constitute accounts in the same way. However, we see a benefit in including in CSDR recital 11 book-entry records within the meaning of the CSDR can be provided through any technical features including blockchain and DLT.

Further, as mentioned under Q18 it should be recognised that since concepts like "book-entry form", "accounts" etc. are subject to national securities law there is a need to foster further convergence between Member States on this matters and therefore we would encourage European Commission to promote initiatives in this regard to address existing fragmentation across the market.

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

	1 (not a concern)	2 (rather not a concern)	3 (neutral)	4 (rather a concern)	5 (strong concern)	No opinion
Rules on settlement periods for the settlement of certain types of financial instruments in a SSS,	X					
Rules on measures to prevent settlement fails.	X					
Organisational requirements for CSDs	X					
Rules on outsourcing of services or activities to a third party.	X					
Rules on communication Procedures with market participants and other market infrastructures	X					
Rules on the protection of securities of participants and those of their clients.		X				
Rules regarding the integrity of the issue and appropriate reconciliation measures	X					
Rules on cash settlement	X					
Rules on requirements for participation	X					
Rules on requirements for CSD links	X					

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Rules on access between CSDs and access between a CSD and another market infrastructure	X					
Rules on legal risks, in particular as regards enforceability		X				

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

Overall, we believe there are no particular issues with applying the current rules in a DLT environment. However, considering some the rules listed above might need a clarification to ensure a smooth application in a DLT context. We refer for instance to the concept of omnibus accounts according to article 38 of CSDR. Those clarification would be particularly important also to ensure that requirements related to legal risks and enforceability are met also in DLT context.

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

As mentioned under Q18 it should be recognised that since concepts like “book-entry form”, “accounts” etc. are in the substance governed by national securities law there is a need to foster further convergence by Member States on this matters and therefore we would encourage European Commission to promote convergence in this regard to avoid fragmentation across the market.

5. AUTHORISATION TO PROVIDE BANKING-TYPE ANCILLARY SERVICES

Question 25: What are the main reasons CSDs do not seek to be authorised to provide banking-type ancillary services? Please explain in particular if this is so due to obstacles created by the regulatory framework.

In a pre-CSDR environment the majority of CSDs were established and regulated in different ways. Some were already regulated as banking entities while others continued to perform limited banking type ancillary services in their role as FMIs strictly in connection to the core services they provided. This difference in approach was very much linked to the CSD’s operations that have been developed and operated in each national jurisdiction. In our view, CSDR has not changed and its strict requirements, notably prudential requirements, have created a high-level structural barrier for entry to CSDs without a banking licence.

Question 26: Have you made use of the option to designate a credit institution to provide banking type ancillary services to CSDs?

- Yes
- No

Question 26.1: If you answered "no" to Question 26, please explain why.

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The conditions to qualify as a designated credit institution ("DCI") are far too strict and prohibitive to such a set-up. This has created a situation in which there is not even the possibility to test the viability of this regime due to the lack of test cases.

As no DCI have been set-up, we can see a lack of foreign currencies suppliers to. The difficulties to access currencies (and central bank money accounts in certain currencies) deter certain asset class (e.g. bonds in non-domestic currencies or investment funds) from choosing to be registered with a given CSD.

Therefore, CSDs and the markets would benefit from a reflection on the regulatory approach to provision of banking type ancillary services.

Recommendation: In this regard we recommend European Commission to evaluate the following actions:

- **Facilitate access to non-domestic central bank money,** within the European Economic Area and third countries, in line with art. 40(2) and art. 59(4)(h) of CSDR, considering the specific regulatory requirements on FMI operations.
- **Reassess the threshold and the percentage used in art. 54(5).** An analysis of CSDR art. 54(5) should be performed, to assess the threshold based on hard evidence gathered per market. The threshold contained therein requires an adjustment according to the reality of each CSD market profile and used currencies. A one-size-fits-all solution is not adaptable to medium and large markets. In particular we believe that the limit of 2.5 billion per year should be removed.

Questions for all stakeholders

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).

The provision of banking ancillary services is subject to strict requirements that may not be proportionate to the risks and volumes of banking-type services provided by smaller CSDs. Notably asset services with a very limited risk profile that could be well mitigated through appropriate measure and should be allowed without the need to require a banking licence. For instance, certain types of instrument, typically bonds, can be issued in currencies other than the domestic one. However, the strict thresholds provided by articles 54 (5) result in barriers preventing the possibility for non-banking CSDs to service the issuance in a non-domestic currency.

Recommendation: Therefore, we recommend reviewing article 54 (5) as follows:

- the limit of 1% should be increased according to the result of an analysis that should be performed on different use cases gathered per market and according to the specific service risks and market profile.
- the limit of 2.5 billion per year should be removed as a one-size-fits-all approach solution has proven to be inefficient.

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- **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.

Please refer to answer to Q27

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

-Yes

Question 33.1: If you answered yes to Question 33, please indicate which elements of the settlement discipline regime should be reviewed:

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

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

LSEG believes that the CSDR implementation timeline must be further reviewed. The legislative process will likely result in potentially overlapping timings between the implementation of the SDR Framework (Feb 2022) and implementation of the amendments of the revised text. This would give rise to the situation where the industry implements SDR in Feb 2022 based on the current text (which includes the challenges the review is seeking to consider and address) then re-implements based on the revised version of the text which is scheduled to be published in Q3 2021, at a later stage. We are of the view that a more rational approach with regard to the application of the SDR is required to prevent legal uncertainty and overlapping work.

Furthermore, and subject to the extent of amendments to be introduced, market participants will need sufficient time to adapt their processes and legal documentation before they can go live with the framework. Last but not least, enough time will need to be dedicated to testing before the framework can go live.

It is thus suggested that the initial entry into application of SDR should be based on the revised version of the text and the date allows sufficient time – perhaps 12 months – from the publication of the final version of the text to go-live.

Additionally, the application of penalties to some instruments like ETF should be reconsidered. Secondary market settlement of these type of securities are often connected to an additional process involving the new issuance in the primary market for creating the required availability of instruments to be delivered (i.e. subscription of new quotes). Such process often determines a delay that prevents timely delivery of ETF new issued securities. This is due to lack of synchronization between the closing time of European regulated trading markets and the deadline

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of the fund for subscriptions on new quotes. Effects of this peculiarity is also acknowledged by ESMA[1] and reported in the T2S statistics (discussed in the '4th CSG Workshop on Market Settlement Efficiency (MSE)', held last 8 October 2020) that shows ETF's settlement efficiency is the lowest in comparison to that of all other financial instruments one. The application of cash penalties will not improve settlement efficiency for these instruments and cannot solve this structural issue and thus possible intervention to mitigate the economic impact should be considered. We kindly ask the authorities to investigate the problem with the relevant stakeholders, including CSDs, to discuss possible solutions such as the eventual need of the reduction of penalty rate, or other.

Finally, we would recommend EC and ESMA review the criteria related to sourcing of prices needed for the calculation of penalties that brings about uncertainty, operational complexities, unnecessary costs and fragmentations. In the actual scenario CSDs are required to run three different processes to identify the source of reference prices, each of them creating technical and operational issues (e.g. download and extract daily data from ESMA FIRST database which has not been created for this purpose so that a number of technical and operational problems occur). Once the relevant source has been identified, CSDs need to buy data on prices from information providers which brings about costs that may vary from CSDs to CSDs and that cannot be recovered entirely from clients. For these reasons, we would recommend EC and ESMA to reconsider the possibility to establish one single source and methodology for the calculation of penalties. In this regard we are keen to work with industry associations and ESMA to identify the best solution.

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

	1 – disagree	2 – rather disagree	3 – neutral	4 – rather agree	5 – fully agree	6 – no opinion
Buy-ins should be mandatory	X					
Buy-ins should be voluntary					X	
Rules on buy-ins should be differentiated, taking into account different markets, instruments and transaction types					X	
A pass on mechanism should be introduced						X
The rules on the use of buy-in agents should be amended						X
The scope of the buy-in regime and the exemptions					X	

[1] Report on Trends, Risk and Vulnerabilities Sept. 2020, page 24 https://www.esma.europa.eu/sites/default/files/library/esma_50-165 1287_report_on_trends_risks_and_vulnerabilities_no.2_2020.pdf

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applicable should be clarified						
The asymmetry in the reimbursement for changes in market prices should be eliminated					X	
The CSDR penalties framework can have procyclical effects					X	
The penalty rates should be revised				X		
The penalty regime should not apply to certain types of transactions (e.g. market claims in cash)					X	

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

With reference to the buy-in procedure we believe that the activation should be handled on voluntary basis for all transactions included in settlement discipline scope regardless whether they are concluded OTC or on the market, cleared or not cleared. This principle is essential to ensure equal treatment between cleared and non-cleared trades and avoid an unintended shift of trading volumes to non-cleared environment, notably for less liquid securities (e.g. corporate and financial Eurobonds). Besides, market operators and infrastructures should have the possibility to deviate from standard rules and procedures in specific market circumstances where the application of buy-in is not the optimal solution and could bring about further complexities. For market and cleared transactions these flexibility in terms of activation of buy-ins and deviation from the standard procedures would be governed by the CCPs and trading venues according to their rules.

As regards to the differentiation of buy-in rules, we believe that timeframes and operational aspects of the procedures should be further calibrated on the specific liquidity profile of securities across the same asset class. This would be welcomed particularly with reference to bonds instruments where the current rules cannot reflect differences in terms of liquidity of instruments belonging to this asset class thus penalizing less liquid securities that needs a longer buy-in period (more than ISD+7). In addition, we should ensure the alignment of timeframes of extension period across cleared and non-cleared transactions as this not currently the case given article 7(5).

Finally, we recommend that the review of buy-in procedure for less liquid securities recognises the role of market makers that is crucial in supporting trading activities on these securities. Indeed, a strict buy-in

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regime challenges the dynamic across trading and inventory activities for market makers and might affect the decision **to provide liquidity for particular securities and prices which they quote on the market**. **Therefore, a proper calibration of the buy-in rules focusing on less liquid securities shall avoid impacts on market makers' trading activities on these securities.**

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

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.

LSEG believes that the application of the SDR during the market turmoil provoked by the Covid-19 pandemic in March, would have had significant impacts on market participants' abilities to satisfy their liquidity requirements. Market volatility combined with large moves in asset prices, especially during stressed market conditions, naturally lead to increases in liquidity requirements. Although markets were sufficient collateralised to handle market volatility, some increases in the settlement fails rates were noticed as drastic measures such as working from home arrangements had to be swiftly implemented. Had they been implemented in Q1 2020, mandatory requirements would have placed additional stress on market liquidity when it was most needed by preventing dealers lending out securities in fear of incurring unnecessary costs.

Particularly in less liquid instruments, and following feedback we have received from market makers we believe mandatory buy-ins would result in widening the spreads to a point where it would become no longer commercially feasible for a market makers to remain registered in specific securities and de-register. The inability of participants to borrow securities when most needed also puts financial stability in question during periods of stress. The market has worked well to respond to the pandemic with no major default or significant liquidity issues and we believe that SDR should not compromise the well-functioning of markets but rather aim at improving it.

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.

LSEG believes in order fulfil CSDR objective which is to harmonise and improve the EU's securities settlement framework and lead to greater overall settlement efficiencies , processing of settlement penalties must be done in a harmonised and highly efficient way to remain relevant and effective, without imposing unnecessary costs to market participants. We have therefore identified the following key areas where we believe significant improvements/clarifications are needed to the revised text.

One single procedure for penalty collection and distribution – Article 17

We believe that the CSDR SDR text introduces contradictions and unnecessary complications with regards to settlement fails and penalties involving CCPs.

Firstly, we believe that Article 17 of the Delegated Regulation is **sufficient** for the collection and distribution of penalties as required by Article 7(2) of the Level 1 text. CSDs would apply the same process for CCP and non-CCP fails, collecting and distributing penalties amongst their participants. The implementation on SDR RTS Article 19 would neither contribute to nor achieve the objective described in Chapter 4.1.2 of the Impact Assessment

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(Annex IV to the Final Report on draft SDR RTS dated 01 February 2016[2]) , namely '*to maintain the appropriate outcome for the penalty mechanism, ensuring that no undue risk is placed on the CCP*.'

Secondly, CSDR Article 7(11), should acknowledge that penalties shall apply to failing CCPs. This was clearly the intention of Article 19 of Commission Delegated Regulation (EU) 2018/1229 (the SDR RTS), whereby CCPs pay penalties for their fails to receiving clearing members.

Further, the remaining provisions of Article 7(11) related to buy-ins should apply to all CCP transactions independent of whether a CCP is a direct participant of the CSD or is a participant of the CSD but uses a third-party agent. This would ensure consistency with the SDR RTS Sections 2 & 3 in relation to the buy-in process for **transactions cleared by a CCP**.

Recommendation:

A. **Article 7 – Measures to address settlement fails should not apply to failing participants which are CCPs**

Article 7 – Measures to address settlement fails

11. Paragraphs ~~2~~ 3 to 9 shall not apply to failing ~~participants that are~~ CCPs.

B. Delete SDR RTS Article 19

To ensure the most efficient implementation of the SDR RTS for penalties and to avoid the unnecessary implementation of two parallel regimes when one would suffice, we kindly request ESMA, together with the European Commission, **to consider deleting SDR RTS Article 19**.

All penalties should be collected and distributed by the CSDs on a single consistent basis with their participants. This proposal aims at addressing issues of operational/legal nature but also development and ongoing costs. It is worth noting that, this is a key proposal widely supported by the broader clearing and investor community.

Addressing unintended losses incurred by CCPs

There is potential for the result of the penalty calculations to leave a CCP with a net loss at no fault of either the CCP or any specific member. Examples are CCP 'box positions' where a CSD doesn't deliver securities from a CCP at end-of-day even though they could and should settle, due to net settlement scenarios with non-DvP cash payments and SME growth market mismatches if related penalties remain on a place of trade basis. Some CCPs intend to recover this loss on a fair mutualised basis from their members. This would be a contractual provision in their rules. It may be that the Commission would wish to confirm the acceptability of this approach in the Regulation.

Further, a clearing member may accrue net penalty liabilities before the point in time they may be declared in default. In paying out all due penalties the CCP would have a loss equal to the defaulting penalty liability. There is a lack of clarity around the manner in which CCPs should manage this potential loss. One option to cover such a default related loss is, as is the norm, to collect margin to cover this future liability. A potential alternative approach, as for the no-fault examples above, is to recover the loss from surviving members on a fair mutualised basis. We would welcome confirmation on the acceptability of the alternative approach.

[2] ESMA final report including RTS - https://www.esma.europa.eu/sites/default/files/library/2016-174_-_final_report_on_csdr_rts_on_settlement_discipline_0.pdf

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Collateral Transfers should be excluded from scope of SDR – Article 7(3)

LSEG believes that transfers of securities collateral (as opposed to securities transactions) should be considered out of scope of the CSDR SDR buy-in regime.

The reason a receiving party demands such collateral is to cover its exposure under one or more transactions. Consequently, it is vital that a failure of the delivering party to transfer collateral to such receiving party is remedied **immediately**. Initiating a buy-in process on ISD + 8 business days (or such other applicable CSDR time period) is irredeemably too late.

The receiving counterparty cannot allow its transaction exposure to continue unprotected in this way. For instance, in a CCP context, if a clearing member fails to transfer collateral to a CCP, the clearing member is contractually and operationally required to address this failure (by providing replacement collateral) **within one hour**. By contrast, a buy-in remedy (with its very delayed timing) cannot be applied in the CCP context. Rather, it only adds a burdensome procedure, and an equally burdensome requirement to incorporate detailed buy-in procedures into its contractual arrangements (Article 25 of RTS 2018/1229), with no benefit or purpose. Moreover, the occurrence of collateral transfers (in a CCP context and otherwise) are varied and prolific, which exacerbates such burden.

We believe that the provision of securities collateral to a receiving party is simply a 'transfer' of securities under a financial collateral arrangement and does not constitute 'the completion of a securities transaction'. Under a collateral transfer, there is no buyer, no seller, and no payment obligations, as there is with a transaction. Accordingly, where a party fails to transfer securities collateral, there is no 'settlement fail' and no 'failing participant' to which a buy-in process would apply under Article 7 (3) of CSDR, because:

(a) 'settlement fail' is defined under CSDR as 'the non-occurrence of settlement, or partial settlement, of a **securities transaction**…' (Article 2 (1)(15)); and

(b) 'failing participant' is defined under CSDR as a 'participant that causes a **settlement fail**' (Article 7 (2)) of CSDR).

Recommendation: We defer to the EC and ESMA as to the best way in which the revised CSDR should exclude such transfers from scope.

Triparty trades should be excluded from SDR – Article 7(4)

LSEG believes that, the processes which are used by triparty system operators for the settlement of triparty obligations are in many instances significantly different from standard DvP/FOP settlements instructions executed by a CSD. The triparty "notices" advise of the collateral basket settlement which is to take place however it is not submitted to a CSD but to a triparty operator.

Article 16 of CSDR RTS solely defines responsibilities in relation to application of penalties relating to CSDs not triparty operators. Following existing market practices where specific CSD settlement instructions are generated by the triparty operator fail to settle, these instructions are cancelled by the triparty operator before the end of day, thus leaving no failed settlement instructions to which penalties can be applied by the CSD. Based on these key triparty processing attributes, it may be that the CSDs/Triparty operators determine that settlement failure penalties do not apply to triparty notifications and cannot be applied to the resulting (cancelled) settlement instructions.

However, Article 26(1) of the Commission's Delegated Acts on CSDR states that "*On the business day following the expiry of the extension period, CCPs shall verify whether a buy-in is possible in accordance with Article 21(a) in relation to any of the transactions it has cleared*." Thus, the CCP has the obligation to buy in triparty transactions. This may then lead to the CCP buy in of transactions to which no settlement failure penalties have been applied.

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In practice, the buy in of triparty transactions by CCPs is often operationally impossible to achieve as transfers of collateral take place following strict pre-defined eligibility criteria in a form of basket securities with no visibility to the CCP on which particular security has failed. Therefore, it is impossible from an operational perspective to accurately apply buy-ins.

It is thus proposed that Article 7(4) should be revised to explicitly exclude triparty repo transactions and any associated CSD settlements generated automatically by the triparty operator. We also like to note that, in its final report (October 2016)[3], ESMA has acknowledged the issue and has agreed to exclude transfers of collateral from the definition of "transactions" in CSDR.

Recommendation: Add an additional exemption to Article 7(4) of Regulation (EU) No. 909/2014 (CSDR)

4) The following exemptions from the requirement referred to in paragraph 3 shall apply:

(a) based on asset type and liquidity of the financial instruments concerned, the extension period may be increased from four business days up to a maximum of seven business days where a shorter extension period would affect the smooth and orderly functioning of the financial markets concerned;

(b) for operations composed of several transactions including securities repurchase or lending agreements, the buy-in process referred to in paragraph 3 shall not apply where the timeframe of those operations is sufficiently short and renders the buy-in process ineffective.

(c) the buy-in process referred to in paragraph 3 shall not apply to triparty transactions and any associated CSD settlements generated automatically by the triparty operator

Consistent application of penalties and buy-ins for SME securities – CSDR Article 7.3

We believe that the current drafting of Article 7(3) of CSDR on SME securities "Where the transaction relates to a financial instrument traded on an SME growth market…". is open to interpretation with regards to the application of the SDR to the SME growth market and introduces a level of uncertainty to both CCPs and market participants. This is due to the fact that an SME security can be traded both at an SME and non-SME growth market in which case two different sets of rules will apply.

We would highlight that this differentiation between SME and non-SME markets in SDR results in market inefficiencies in the form of reduced netting benefits but also in inconsistencies in the application of penalties and buy-ins where the same security has been traded in both an SME and non-SME growth market.

We would therefore recommend that existing exemptions granted for SME securities are made consistent for SME securities traded on an SME growth market or elsewhere. The extension period should also be the same in all cases and defined in **business** days to be consistent with all other period definitions.

Alternatively, the special case for 'SME growth market' trades is removed in its entirety, with the special provisions for lower liquidity provisions applying, providing a cleaner simplified approach.

Recommendation:

[3] ESMA final report including RTS - https://www.esma.europa.eu/sites/default/files/library/2016-174_-_final_report_on_csdr_rts_on_settlement_discipline_0.pdf

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A. Consistent application of the regulation for SME securities traded on both SME and non-SME markets

Article 7(3)

3. Without prejudice to the penalty mechanism referred to in paragraph 2 and the right to bilaterally cancel the transaction, where a failing participant does not deliver the financial instruments referred to in Article 5(1) to the receiving participant within 4 business days after the intended settlement date ('extension period') a buy-in process shall be initiated whereby those instruments shall be available for settlement and delivered to the receiving participant within an appropriate time-frame.

Where the transaction relates to a **designated SME growth market instrument, irrespective of where the trade occurred** ~~financial instrument traded on an SME growth market~~ the extension period shall be 15 **business** days ~~unless the SME growth market decides to apply a shorter period~~.

Buy-in procedure for Cleared Transactions

LSEG's implementation of the buy-in requirements under the Short Selling Regulation takes an approach which is operationally simpler than the requirements of CSDR and can also result in better settlement efficiency than the requirements of CSDR.

Our approach uses a buy-in agent settling on a T+2 basis (not guaranteed). The original failing party does not put their fail on hold and can therefore settle the fail as soon as they have the shares. CSDR does not allow this, requiring the hold transaction to remain, and downstream fails continuing until the buy-in agent delivers to the CCP. LSEG intends to continue with this approach for fails not covered by CSDR.

We are of the opinion that, as far as cleared transactions are concerned, existing market practices such as the one described above can provide for a more efficient and streamlined buy-in procedure **and should not be excluded as an option by CSDR.**

Payment of Price difference on buy-ins

Article 35(1) requires the price difference between the original price of the purchase of the relevant securities and the buy-in price to be collected from the failing clearing members and paid to the receiving clearing members. We believe that the current drafting of the Regulation where it requires the CCP to pay this price difference to receiving members is in error as it would result in a guaranteed loss to the CCP, the price difference being required to pay the buy-in agent. Transactions with the receiving members should settle on the original terms. Any additional payment to receiving members would be an unwarranted windfall profit. As such we suggest removing the second paragraph in Article 35(1) as per below.

Recommendation: Delete second paragraph of Article 35 (1)

Payment of the price difference

Where the price of financial instruments referred to in Article 5(1) of Regulation (EU) No 909/2014 agreed at the time of the trade is lower than the price effectively paid for those financial instruments pursuant to Articles 27(10), 29(10), and 31(10), the failing clearing members, failing trading venue members or failing trading parties shall pay the price difference to the CCP, receiving trading venue members or receiving trading parties, as applicable.

~~Where transactions are cleared by a CCP, the price difference referred to in the first subparagraph shall be collected from failing clearing members by the CCP and paid to the receiving clearing members.~~

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Price determination for cash compensation following failed buy in

With regards to the treatment of a buy-in that has failed, Article 32 (3) requires that the price used to determine the level of cash compensation must be based on that of the closing price of the trade venue within the Union with the highest turnover. We would note, however, that there is no guidance on the criteria utilised to determine this venue leading to potential confusion. Where CCPs are determining the price to be used to calculate cash compensation, they should have the option to use the prices the CCP has determined for its risk management purposes.

Recommendation: Provide additional clarity in Article 32 (1) for cleared transactions

The market value referred to in Article 32 (1) shall be determined as follows:

(b) for financial instruments admitted to trading on a trading venue within the Union other than those referred to in point (a), the value determined on the basis of the closing price of the trading venue within the Union with the highest turnover

(c) Where market values are being determined by a CCP, they may also utilise security prices which have determined for their risk management purposes.

Short-life Assets should be out of scope of SDR – Article 7(4)

We believe that, trades in subscription rights/rights issues or voluntary Corporate Action events should be fully exempt from buy-ins, due to (i) their limited life span (typically between 10 and 20 days), (ii) small market value, and (iii) lack of value after they have lapsed. Furthermore, as buyer protection procedures may apply to these transactions, buy-ins would unreasonably interfere with these buyer protection procedures increasing market risk.

Recommendation: We would recommend the following additional paragraph in Article 7(4) exempting such trades from scope of SDR.

4) The following exemptions from the requirement referred to in paragraph 3 shall apply:

(a) based on asset type and liquidity of the financial instruments concerned, the extension period may be increased from four business days up to a maximum of seven business days where a shorter extension period would affect the smooth and orderly functioning of the financial markets concerned;

(b) for operations composed of several transactions including securities repurchase or lending agreements, the buy-in process referred to in paragraph 3 shall not apply where the timeframe of those operations is sufficiently short and renders the buy-in process ineffective.

(c) for failing transactions on securities which are rights or are impacted by buyer protection, the buy-in process referred to in paragraph 3 shall not apply where due to the short life span of the security the buy-in process would be ineffective

Identification of 'Shares' Instruments should be further clarified

The Classification of Financial Instruments published by ESMA[4] provides that that "CSDR settlement discipline regime will apply to securities issued by ETFs depending on their legal characterisation". Given that the large majority of market infrastructures (CSD and CCPs) do not handle this level of granularity in their static data we

[4] FIRDS CFI validations' [Reference ESMA70-145-1090], available at https://www.esma.europa.eu/document/firds-cfi-validations

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believe that the proposed way to determine the applicable buy-in deadline for ETF is cumbersome as it introduces an additional level of differentiation which has never been applied previously. We understand that the recommended approach is in line with that from ECSDA. As such ETFs would not be shares as their CFI code starts CE.

Recommendation: We would suggest the following statement: "'Shares' are those instruments classified as 'equities' with CFI codes starting with an 'E', as defined on the ESMA document 'FIRDS CFI validations' [Reference ESMA70-145-1090].

We hope that you will find LSEG's input provided in this consultation paper useful and we remain at your disposal for any additional clarifications.

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