Comments by HANFA on the EC Consultation paper
- Additions to the EC Survey responses -

We thank the Commission for the well thought-out Consultation paper, which will serve as a good starting point for the work ahead.

Since there is a limitation of up to 5000 character(s) including spaces and line breaks under each question of the Survey, some of our resposnes did not fit into the space provided. Therefore, we would like to seize the opportunity to present our responses in full as follows.

I. ***"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 generally share the view of the Commission that large parts of CSDR have not been put into practice yet, either because of the longer than anticipated authorization process for EU CSDs, or because of subsequent delays in application, e.g. the settlement discipline regime. Therefore, it is true that, for many of the provisions, we lack concrete data on how the logic behind CSDR's provisions would actually perform in practice and where problems might arise. However, this does not mean that CSDR could not benefit from a holistic overhaul, where we would suggest that the review focuses on the following priorities:

1) **Priority 1: Making sure that CSDR level 1 is in fact as technology neutral as possible.** We believe that this is crucial for the future of EU financial infrastructures and for the future competiveness of the EU in this field. We agree that a pilot project could be one way forward, and it would certainly be a good way to gather more data and adapt afterwards. But, we caution that a model that is based on the idea of derogations from CSDR provisions granted individually by NCAs could be very challenging in practice and could lead to a very un-level playing field for EU DLT based CSDs. The question that naturally arises is – if a CSDR provision (either Level 1 or level 2) is not possible to be applied to a DLT based infrastructure and therefore has to be waived, what applies in its place? This can create regulatory competition between MS. Second, because the CSDR (and all legislation) is self-consistent (or at least tries to be), if we take many relevant pieces out, we risk all the rest falling apart because it no longer works as a whole. How many CSDR provisions would be have to waived, and what are these provisions? While we can see the benefit of having this sandbox structure in place for experimentation (especially if it is applied for activities below a certain threshold), to see what kind of permutations would arise, we can also see the downsides and the risks that can emerge. Another issue is that setting up a financial infrastructure is expensive and requires considerable investments, and a pilot regime would likely be limited in duration. We caution that this period should not be too short, as this will provide disincentives to take part in the pilot project. We would also ask for more clarity on the Commission vision of how the pilot project would work from a legal point of view, and possibly indications on how it could be safely decommissioned if it were to prove unsuccessful.

Our preferred course of action for the CSDR review would be still be to make the effort to identify provisions that lack technological neutrality at Level 1 now, and to review them as much as possible. This would be done in parallel with the work on the pilot project, and would be reviewed again at the appropriate stages as the pilot project runs its course (here we note that more clarity on the nature of the pilot project would help us determine if this is possible). An alternative solution could be an „equivalence model". By this we mean that the pilot project would need to look at all the CSDR provisions, at the proposed new technology workflow, and provide an assessment of why alternative provisions deliver the same outcome as the CSDR

requirements. In practice, this means asking: what is this CSDR rule for? Does a different, technology-specific new rule/process deliver the same result or even a superior one with the same level of risk? If yes, then the new rule would be recognized as „equivalent". With possibly a control mechanism to make sure that we are all playing by the same rules. This principle could be explored in CSDR, to actually make it technology neutral.

We also caution that it would be short-sighted to tackle issues such as the scope of CSDR, especially those linked to the definition of financial instruments, without very carefully taking into account the ongoing work on legislating digital/crypto assets (the "MiCA" proposal) and related changes to MiFID. The interaction there will be crucial for ensuring the technological neutrality of CSDR and the pilot project.

Furthermore, the one of the main obstacles to a DLT based CSD may be in the provisions of the settlement finality directive, which would also have to be reviewed.

2) **Priority 2: Focus on the issues already identified by NCAs and ESMA in the application of CSDR.** Examples are cross-border provision of services, the issue of law that governs the issuance, the settlement discipline regime, adaptations to simplify the internalized settlement-reporting regime and to put proportionate mechanisms in place to further address the risks of internalized settlement if they arise, the review and evaluation process, etc. We see that the Commission has also placed an emphasis on these areas and we support this intention.

3) **Priority 3: Close the gaps in CSDR that we have identified so far.**

a) One example is the issue the obligation of NCAs to have a resolution plan in place for the CSDs that they supervise. CSDR has only one sentence that refers to resolution of a CSD, which is the already mentioned obligation. However, there is no harmonized framework for CSD resolution in place and many MS do not have a national law that would cover the resolution of a CSD, unless that CSD also does not have a limited banking license, and potentially enters into scope of BRRD. The issue is that this places a very complicated burden on both MS and the NCAs that had to either come up with a national law on how to resolve a CSD , or figure out how to apply BRRD to CSDs (with no ancillary banking services). Both approaches can cause level playing field issues, and, in case of cross-border services, possibly serious conflict of law issues. Issues of information gaps between supervisory and resolution authorities may arise, both domestically and between MS. While do not believe that it would be possible or advisable to come up with a resolution regime for CSDs within the CSDR review, more guidance should be provided for MS and NCAs on how this obligation should be complied with. Which is extremely difficult, if not impossible to do without a harmonized framework – which we do not have (unless the CSD is a bank, in which case it's covered already by BRRD). Alternately, this provision could be removed from CSDR and we should engage in separate further discussions on whether a resolution framework for CSDs (with or without ancillary banking services) is in fact needed. For non-banking CSDs, an argument could be made that it is in fact, not needed.

b) Another gap is the provision of CSD services by third country CSDs, where the text does need additional clarity. However, we do recognize the lack of practical application of these provisions and the potential Brexit issues that may impact some MS that may suggest that these provisions could be left up to a subsequent review of CSDR.

4) **Priority IV: Running a "proportionality check" on all Level 1 and related Level 2**

provisions.
An example could be:

a) Onerous nature of the annual review and evaluation process

Amend the frequency of the review and evaluation process. A yearly mandatory review process does not add value and risks becoming burdensome considering that (i) NCAs have continuous supervisory powers and that (ii) any changes to most of the information for the review process shall also be notified to NCAs without undue delay (Art.16(4)). We would suggest to consider less frequent mandatory review (e.g. every three years), or to put it at discretion of the NCA.

b) Likely disproportionate burden of the mandatory use of open international communication standards in Article 35 of CSDR, or the equivalent obligation of investment firms at Level 2 (the RTS on settlement discipline)

The last paragraph of Article 2(1) of Commission Delegated Regulation (EU) 2018/1229 makes it mandatory for investment firms to offer its client the option to use international standards, however, Esma in its Guidelines on standardized procedures and messaging protocols (06/04/2020 | ESMA70-151-2906) has decided to use the reference to the existing CSDR Q&A 4(a) (use of the international open communication procedures and standards for messaging and reference data referred to in Article 35 of Regulation (EU) No 909/2014) in relation to the two cases justifying a disapplication of Article 35 of CSDR (please see paragraphs 20 to 22 of the Guidelines).

Even though we understand that the automatization of all the trade lifecycle should be promoted as far as possible but at this stage of time, when there are still a number of CSDs not licensed under CSDR and a quite number of those CSDs relate to smaller CSDs and smaller market, we believe that the use of international open communication procedures and standards for messaging and reference data referred to in Article 35 of CSDR, would be too difficult for smaller investment firms and this would represent one more example of disproportionality in comparison to larger investment firms and CSDs operating in some MSs. We would like to note that CSDR Q&A in its CSD Question 4 deals with the use of such standards only for CSDs in relation to participants of the securities settlement systems they operate but not in relation to participants' communication with their professional clients. We are aware that Article 2(2) of the Settlement Discipline RTS requires that investment firms (as CSD participants) provide their professional clients with the option of sending the written allocation and the written confirmation electronically, through the international open communication procedures and standards for messaging and reference data referred to in Article 35 of Regulation (EU) No 909/2014, however, we believe that the direct reference to a Q&A which is specific to CSDs may be premature and should first be reviewed from the perspective of IFs and their clients.

c) Introduction of the definition of outsourcing

We would suggest including a new definition on 'outsourcing' and 'service provider', as the CSDR currently does not specify the definition of outsourcing or its scope, which may lead to confusion in relation to the provision of services by third parties. In addition, we suggest to explicitly state if FMIs and common securities settlement infrastructures operated by central banks (or other public entities, as defined under the CSDR) are to be considered as a CSP or not (currently covered under Q6 of the ESMA Q&A on CSDR).

d) <u>Acquisition of a qualifying holding in a CSD</u>

An area where we would consider, actually, increasing the requirements is the acquisition of a qualifying holding in a CSD, where the threshold is currently set at attaining control (unlike investment firms, asset management companies, banks, insurance or CCPs). We propose replacing the concept of the 'participation' and 'control' (Art. 2(1) point 20 and 21 and Art. 27 of CSDR) with the concept of the 'qualifying holding' under MIFID and EMIR. It is not logical or at least we are not aware of the logic behind the fact that requirements for acquisition of a qualifying holding of at least 10% in an investment firm are much stricter than the rules for acquisition of a qualifying stake in a financial infrastructure such as CSD since there is a procedure according to CSDR only when someone acquires a controlling stake that can be far above the 10 % of the voting rights or of the capital of CSD. Therefore, we propose to replace the concept of 'exercising control' with the concept of a 'acquiring of a qualifying stake' under MIFID and EMIR.

e) <u>More proportionality in general</u>

A more basic proportionality question is: do we allow small CSDs, and how can we accommodate for them in a proportionate way? Or do we have room only for larger infrastructures? This is also linked with the upcoming pilot project and sandboxes in general. If we allow sandboxes (including the DLT pilot project), we better have a way of enabling small & viable projects (because nobody will sandbox a full-blown infrastructure). Therefore, proportionality becomes a pre-condition for sandboxes. In other words: if we solve the viability of small CSDs (as a sand-box proxy), we can translate this to wider technology sandboxes.

II. "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?"

A. IN GENERAL

As a general comment, we are supportive of the intention behind the CSDR passporting regime, but we also believe that there are practical and legal issues with the current provisions that need to be resolved.

As one of the potential problems raised by stakeholders seems to be the obligation to comply with the national corporate law that governs the issuance, the possibility that this requirement may be deleted raises several concerns:

1) the definition of a host MS (and NCA) is linked to the requirement that the CSD has to provide CSD services in this MS , and the provision of CSD services in a MS is currently linked to the Article 23 process and the MS whose corporate law applies – this has consequences in terms of the applicability of Article 24. cooperation provisions;

2) CSDR should not amend or change national corporate law that governs the issuance, and cannot empower CSDs from other MS to disapply it;

3) the current texts of Article 23. and Article 49. are unclear and has led to different interpretations in practice that ESMA and NCAs had to resolve at Level 3.

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B. IMPROVING THE PROCESS FOR OBTAINING THE CSD PASSPORT

We believe that a revision of these provisions is necessary, but this revision should not attempt to harmonise MS corporate law or to allow it not to be applied if a CSD from another MS provides services to an issuer – certainly not without a thorough and evidence based discussion.
We believe that the problems that had arisen in the application of Article 23 had their roots in the somewhat vague nature of the provisions of Article 23 (also in connection with Article 49).

The issues were:
1) how to determine the law under which securities are constituted (an therefore also the host MS/NCA)?
2) when is the assessment process by the host NCA triggered?
3) what are the relevant provisions of that corporate law that need to be assessed by the CSD/NCA?

Many of these issues have been subsequently and recently addressed by ESMA guidance (Q&A, a new harmonised template for the national corporate law provisions that apply in the context of Article 23. and 49.). However, the issue of which law should be considered as "the law under which securities are constituted" and which MS(s) should be considered as the host MS is still being debated. We agree that there are still gaps and that it would be preferable to clarify them at level 1.

We would also need more concrete evidence on the operational and legal difficulties that arise for CSDs from the obligation to include an assessment of the measures the CSD intends to take to allow its users to comply with the national law under which securities are constituted, before we can consider the need for its deletion. However, we do acknowledge that the procedure in Article 23(3) is in itself burdensome, and may be more suitable for e.g. investment services, than for CSDs. We would be willing to explore a simplification, with the following conditions. Our main concern is to ensure that the NCA of a MS whose issuers use a CSD from another MS is not excluded from information flows and cooperation provisions in Article 24. by either a change of what is meant by the "the law under which securities are constituted" or by the deletion of such a requirement from Article 23(3). It should also be clear that the national law under which securities are constituted still applies to the issuers (contractual derogations for instruments such as bonds notwithstanding) and that CSDs are still obliged to comply with it.

C. THE MAIN OBSTACLES IN RELATION TO OBTAINING THE CSD PASSPORT

We believe that one issue certainly was one of interpretation and the lack of clarity in the CSDR Level 1 provisions.

We can address the issue by clarifying the following questions:
1) what is the law under which securities are constituted?
2) what are the relevant provisions of that corporate law that need to be assessed by the CSD?

However, as we stated above, the current text of CSDR when it comes to cross-border services may be too complicated. The bigger concern is that the notification process for FOS is explicitly and exclusively linked to the provision of core CSDR services "in relation to financial instruments constituted under the law of another MS". This: a) complicates the process; b) MS whose issuers (established in that MS) choose to use the services of a CSD established in another MS (and that choose a corporate law different then the national law of

the MS of the issuer) would not be able to get any information on the activities that the CSD performs in their MS, as their NCAs would not be considered a "host MS authorities". This would mean that the mechanisms foreseen in Article 24. of CSDR would not apply to them at all. We would want the CSDR review process to address that.

The relevant CSDR provisions are:

1) Recital 56 – what is considered corporate law under which the securities are constituted

(„Since harmonization of national corporate law is beyond the scope of this Regulation, such national corporate or similar law under which the securities are constituted should continue to apply and arrangements be made to ensure that the requirements of such national corporate or similar law can be met where the right of choice of CSD is exercised. Such national corporate and similar law under which the securities are constituted govern the relationship between their issuer and holders or any third parties, and their respective rights and duties attached to the securities such as voting rights, dividends and corporate actions.")

2) Definitions, Art. 2.(1) point 24: „24) 'host Member State' means the Member State, other than the home Member State, in which a CSD has a branch or provides CSD services";

3) Article 49(1) – „ An issuer shall have the right to arrange for its securities admitted to trading on regulated markets or MTFs or traded on trading venues to be recorded in any CSD established in any Member State, subject to compliance by that CSD with conditions referred to in Article 23. Without prejudice to the issuer's right referred to in the first subparagraph, the corporate or similar law of the Member State under which the securities are constituted shall continue to apply."

4) Article 23. paragraph 2. „An authorized CSD that intends to provide the core services referred to in points 1 and 2 of Section A of the Annex in relation to financial instruments constituted under the law of another Member State referred to in Article 49(1) or to set up a branch in another Member State shall be subject to the procedure referred to in paragraphs 3 to 7."

5) Article 23. paragraph 3. „Any CSD wishing to provide the services referred to in paragraph 2 within the territory of another Member State for the first time, or to change the range of those services provided shall communicate the following information to the competent authority of the home Member State:
(a) the Member State in which the CSD intends to operate;
(b) a programme of operations stating in particular the services which the CSD intends to provide;
(c) the currency or currencies that the CSD intends to process;
(d) where there is a branch, the organizational structure of the branch and the names of those responsible for the management of the branch;
(e) where relevant, an assessment of the measures the CSD intends to take to allow its users to comply with the national law referred to in Article 49(1).

6) Article 23. paragraph 4. „Within three months from the receipt of the information referred to in paragraph 3, the competent authority of the home Member State shall communicate that information to the competent authority of the host Member State unless, by taking into account the provision of services envisaged, it has reasons to doubt the adequacy of the administrative structure or the financial situation of the CSD wishing to provide its services in the host Member State."

7) Article 23. paragraph 6. „6. The CSD may start providing the services referred to in paragraph 2 in the host Member State under the following conditions:

(a) on receipt of a communication from the competent authority in the host Member State acknowledging receipt by the latter of the communication referred to in paragraph 4 and, where relevant, approving the assessment referred to in point (e) of paragraph 3;
(b) in the absence of any receipt of a communication, after three months from the date of transmission of the communication referred to in paragraph 4."

We interpret the quoted provisions of CSDR as follows (there could be different interpretations, therein lies the problem):

- If a CSD intends to offer core services to issuers established in other Member States, it can do so under the freedom to provide services or through a branch (Article 23(1) of CSDR).

- If a CSD intends to provide core services to issuers established in other Member States under the freedom to provide services (FOS), the procedure referred to in para 3 to 7 of Article 23 of CSDR applies only if the financial instruments issued by those issuers are constituted under a law different than the one of the MS where the CSD is established. The host MS is the one of the law under which the securities are constituted, which is not necessarily the MS where the issuer is established. If the MS of the law under which the securities are constituted is not the MS where the issuer is established, then the MS of the issuer's establishment is neither notified or considered a host MS. This also means that no provisions that govern cooperation arrangements would apply to the NCA of the MS of the issuer's establishment.

- If a CSD intends to provide core services to issuers established in other Member States through setting up a branch (FOE), the procedure referred to in para 3 to 7 of Article 23 of CSDR applies regardless of which corporate law applies.

D. HOW TO ADDRESS THE OBSTACLES

We suggest to resolve the issue of the definition of the "host MS" mentioned above (where the MS of the law under which the securities are constituted is not the MS where the issuer is established), to ensure that the MS where the issuer is established is considered a host MS for the purposes of CSDR. This would not exclude the MS of the law under which the securities are constituted, but add to it. If this is resolved, we can consider further simplifications of the notification process, by e.g, limiting the ex-ante assessment of the law under which the securities are constituted only to shares.

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

Here, we see the link with the SFD review. We strongly encourage the SFD's tech neutrality, which should be one of the key points of the current review. In principle, there should be no reason why a system operator could not operate a system which is at the same time DLT based and SFD compliant. Any provisions of SFD that could preclude a DLT based system from being SFD compliant, solely because they were tailored to the current technology, should be carefully reviewed and amended.

In any case, a DLT securities settlement system that can demonstrate its compliance with all of the requirements of SFD should not be precluded from being designated and notified in accordance with SFD provisions. As it is also important to maintain consistency between this review process and the review of CSDR and the Commission Digital Finance Package, we note that this is in fact specifically mentioned in RECITAL 23 of the DLT PILOT REGIME.

DLT Pilot Regime, recital 23: "DLT securities settlement system that applies to be exempted from the participation requirements of Regulation (EU) No 909/2014 (the Central Securities

Depositories Regulation) would not be compliant with the participation requirements of Directive 98/26/EC. Consequently, such a DLT securities settlement system could not be designated and notified under that Directive. However, this would not preclude a DLT securities settlement system that complies with all of the requirements of Directive 98/26/EC from being so designated and notified."

However, there are more specific issues that need to be discussed as well, depending on how DLT securities settlement systems will operate in the future and how and if they will deal with e.g. netting. Current settlement systems use netting or multilateral netting or real time gross settlement in the way which makes impossible to track each individual security or money before, during and after settlement. Only fungible asset can be transferred in payment or settlement systems. In this context, fungibility means that no single security or money has a "label" or "flag" identifying their previous owners, whether they were used as collateral or stolen or who else had proprietary rights to those securities or money. Otherwise it would be impossible to use omnibus accounts in which securities or money of many clients are commingled together without any chance to find out which securities or money originally belonged to which client.

It is currently unknown if or to what degree DLT systems will require fungibility and where they do, to what degree will it be possible to track each individual security back or forward as if the security or money has a label with all its history of owners. If DLT systems do not use netting and gross settlement, theoretically, an insolvency administrator would be able to track precisely which specific securities belong to a defaulting participant (which is impossible in "legacy" SFD systems). This specificity will also need to be taken into account and discussed further.

Even though we believe that current definitions or concepts in SFD might be interpreted (extensively) in a way
that a DLT system could be SFD compliant, we would prefer to further clarify and fine-tune some definitions and concepts in a DLT context, while avoiding falling into the trap of adapting the SFD just to the latest technology.

If amendments were to be made, it could be useful to write a principle based legal definition of "DLT based SFD system" and to clarify the term "participant" in DLT based SFD system, however, a preferred method could be to find a way to make the definitions even more "future proof" if and when a new tech solution outshines and replaces DLT. These concepts would then be further developed by the rules of the system itself. We are internally looking into if an amendment to the definition of a "settlement account", "book entry", "securities", "collateral security" is needed in a DLT context, and if yes, what the amendment could look like. We are still formulating a position. As is the usual practice, the moment of entry of a transfer order into a system and the moment of irrevocability of transfer orders in DLT context can be be defined by the rules of that system.

A further point of clarity that could facilitate further discussion is what we mean when we say a "DLT based SFD system"? What do we want to cover? Is this a system that uses DLT technology to execute transfer orders in securities or money in general or would it be strictly related to settling transactions in DLT transferable securities (that would be issued, recorded, transferred and stored using DLT) in systems which could be SFD compliant. Does DLT based SFD system imply that the book-entry form of the security and its settlement account would also have to be DLT based? Or would it be possible to separate the two?

However, for securities settlement systems a larger issue may be interaction with CSDR, specifically Level 2 of CSDR. We are aware that this is being dealt with under a separate review process that is ongoing, but we urge the Commission to maintain consistency between

this review process, the CSRD review and the DLT Pilot regime, to the greatest degree possible.

IV. "Question 31. Do you consider that certain requirements in CSDR would benefit from targeted measures in order to provide further legal certainty on their scope of application?"
"Question 31.1 If you answered "yes" to Question 31, please specify what clarifications/targeted measures could provide further legal certainty."

Besides the topics we already mentioned at the very beginning, we would like to address a few additional issues.

We caution that it would be short-sighted to tackle issues such as the scope of CSDR, especially those for example, linked to the definition of financial instruments, without very carefully taking into account the ongoing work on legislating digital/crypto assets (the "MiCA" proposal) and related changes to MiFID. The interaction there will be crucial for ensuring the technological neutrality of CSDR and the pilot project.

1) As a general comment, CSDR would benefit from abandoning the approach (in the definitions part) which likens "securities" to all financial instruments, which can lead to confusion on the issue of which provisions apply to which financial instruments.

2) We would suggest including a new definition on 'outsourcing' and 'service provider', as the CSDR currently does not specify the definition of outsourcing or its scope, which may lead to confusion in relation to the provision of services by third parties. In addition, we suggest to explicitly state that FMIs and common securities settlement infrastructures operated by central banks (or other public entities, as defined under the CSDR) are not to be considered as a CSP (Q6 of the ESMA Q&A on CSDR).

3) Further, the scope of the buy-in regime and the exemptions applicable should be clarified. As an example:

- is the scope of buy-ins is limited to transactions on the secondary market?
- are UCITS and AIFs ancillary settlement instructions in or out of scope?
- are SFTs in or out of scope?
- are settlements related to derivatives contracts, collateral movements/margin transfers, intra-entity transfers of securities, primary market transactions in ETFs, and other transactions that do not directly represent the outright purchase and sale of a security (or the transfer of ownership of a security) in or out of scope?
- are trades in subscription rights/rights issues out of scope (due to short life span)?
- should mandatory buy-in and cash penalties apply to settlement fails arising in the context of physical settlement of physically settled derivatives?

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

Our position is that the settlement discipline regime needs to be reviewed before it can be applied. Although it has not started to apply yet, there are already various open issues and

uncertainties about its general principles. From a position of an NCA in MS with one small CSD outside the Eurozone and T2S (CSD is under the authorization process) we can see so far that there is a need for clarification of certain general principles especially regarding the hold and release mechanism for which we deem must be used in a fair manner and justified on the basis of objective criteria. The results of the ESMA survey showed that various aspects of the settlement discipline regime lacks clarity and that there are major differences in practice (especially in regards to hold and release mechanism).

We agree with many of the arguments presented by stakeholders on downsides of the mandatory nature of the buy-in mechanism (especially for uncleared markets), and see the need to consider a number of derogation or optionality. A more phased out approach for the buy-in should also be considered. One way to resolve this would be to move the mandatory/optional nature of the buy-in and the operational details (i.e. the length of the period I which the buy in is supposed to be initiated) to level 2, to ensure more flexibility.

If the mandatory nature of the buy-ins is changed, this may need to be followed by a tightening of provisions for periodic penalties. What could work as an incentive mechanism is an introduction of a metric/benchmark of what a reasonable level of success (in stopping settlement fails) means, which is then used to determine if actions are needed.

Example: if settlement fails are below a certain %, nothing needs to be done (in terms of a mandatory buy-in); if they are above a certain %, then mandatory provisions and buy-in are triggered.

It should also be noted that the settlement discipline regime should not be reviewed in isolation from the larger issue of evolving the settlement system through the use of new technology (which is DLT today, but may be something altogether different tomorrow).
Which may be one more reason to review the entirety of the settlement discipline regime and make it more principle based at level 1, and then develop it at level 2.

VI. ***"Question 33.1: If you answered yes to Question 33, please indicate which elements of the settlement discipline regime should be reviewed: (you may choose more than one options)***
- ***Rules relating to the buy-in***
- ***Rules on penalties***
- ***Rules on the reporting of settlement fails***
- ***Other***

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

Even though we do not have practical examples at the domestic level in relation to hold and release mechanism, through the discussions held within the ESMA committee, we became aware that there are various divergent views as to what the purpose of this mechanism is and when it can be applied.

The way we read the text of the Settlement Discipline Regulation is that the purpose of the hold and release mechanism is to prevent end reduce the risk of settlement fails. If we all could agree that this is a purpose of this mechanism than it is clear when a mechanism could be applied. But the problem is that this mechanism is already in practice for most markets and there are divergent views when it comes to its purpose. Some participants believe that the primary purpose of the mechanism is not settlement efficiency but avoidance of the undue usage of cash or securities positions, avoidance of future penalties and additional recycling costs, to influence sequence of transactions to be settled etc. and that the mechanism can be

applied after the intended settlement date (after ISD).

Here we believe that hold and release mechanism cannot be applied to matched instructions for which ISD has occurred (e.g. after instructions are matched and are failed on/after the ISD) because the 'failed transaction' already happened so, putting on hold such 'failed' transaction would not prevent it from being failed and the purpose of the hold and release mechanism as a tool for prevention and decrease the risk of settlement fails, is impaired.

The current text of the RTS seems to imply that this is a mechanism used in the context of the settlement discipline regime, used only to prevent settlement fails according to Article 8 of the SD RTS (here we note again that we need to clarify what is meant by "pending settlement instructions", since Article 11. of the RTS treats them differently depending if the ISD has passed or not - "(a) pending settlement instructions that can still be settled on the intended settlement date; (b) failed settlement instructions that can no longer be settled on the intended settlement date".

However, even if this is the case (that H&R mechanism can be applied before and on ISD), that does not mean that (additional) parts of the functionality cannot be outside of the SD regime, and it does not mean that these parts should be banned (if there is a justified use-case). It would only mean that a particular part of the functionality falls outside the scope of Article 8 of the RTS, and would be assessed on a case-by-case basis.

Therefore, we suggest reviewing the text of the CSDR and even more the text of the SDR in order to clarify the main principles and objective criteria for usage of this mechanism (before ISD has occurred) but at the same time, leaving space for certain functionalities which would then be clearly outside this mechanism as such, but within the SDR.

VII. "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."

We agree with many of the arguments presented by stakeholders on downsides of the mandatory nature of the buy-in mechanism (especially for uncleared markets), and see the need to consider a number of derogation or optionality. A more phased out approach for the buy-in should also be considered. One way to resolve this would be to move the mandatory/optional nature of the buy-in and the operational details (i.e. the length of the period I which the buy in is supposed to be initiated) to level 2, to ensure more flexibility.

If the mandatory nature of the buy-ins is changed, this may need to be followed by a tightening of provisions for periodic penalties. What could work as an incentive mechanism is an introduction of a metric/benchmark of what a reasonable level of success (in stopping settlement fails) means, which is then used to determine if actions are needed.

Example: if settlement fails are below a certain %, nothing needs to be done (in terms of a mandatory buy-in); if they are above a certain %, then mandatory provisions and buy-in are triggered.

It should also be noted that the settlement discipline regime should not be reviewed in isolation from the larger issue of evolving the settlement system through the use of new technology (which is DLT today, but may be something altogether different tomorrow).

Which may be one more reason to review the entirety of the settlement discipline regime and make it more principle based at level 1, and then develop it at level 2.

Comments by HANFA on the EC Consultation paper
- Additions to the EC Survey responses -