France Post Marché Contribution to :

ESMA : Consultation - Technical Advice on the Scope of CSDR Settlement Discipline

Q1 Do you agree with ESMA's proposal regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions? Please specify which cases you agree with and which cases you don't agree with (if applicable). Please justify your answer and provide examples and data where available.

France Post Marché welcomes the 4 propositions of exemptions as proposed in the consultation, clarifying by regulatory inclusion points stated in ESMA FAQ in the past.

These additional cases are justified, nevertheless it must be ascertained that implementation of some will not cause difficulties or undue side effects like manual actions/modifications on instructions. (please refer to our answer to question 6)

Moreover, for the case of exemption mentioned in point 18) ii. (i.e. "settlement instructions put on hold due to the order issued by a court, the police or similar authority with relevant mandate") clarifications should be provided on the intended scope of exemptions. Would, for example settlement instructions put on hold due to sanctions and embargoes on individuals, entities and countries communicated by relevant authority with similar mandate be considered?

Q2 ESMA would like to ask for the stakeholders' views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions). Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

We have not assessed quantitative impact or costs/benefits for the exemption's implementation.

We consider implementation of new rules for detection, determination will impact any penalties engine manage by infrastructures and participants which have implemented their own penalties computation, replication mechanism. It could also have impact on market data side by considering some new information to be implemented, communicated, and stored for usage.

One of the benefits would be the officialization of these exemptions will bring clarity and certainty and help either by avoiding the penalty or by easing the resolution of an appeal process.

May implementation of exemption be in "ex-post", it would provoke additional use of appeal, manual and operational intervention all along the chain, in short timeframe appeal period delay. (please refer to Q6)

Q3 Do you have other suggestions regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions? Please justify your answer and provide examples and data where available.

We do not foresee as such other cases or other events that could be considered for exemption.

Q4 If you have answered yes to the previous question, please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

Q5 Do any of the exemptions proposed above break the immunization principle? Please provide examples and arguments.

Immunization is a key driver of the whole penalty mechanism good processing. As soon as the exemption does not apply evenly on all the failing instructions there is a risk for this principle to be broken. This might be the case for exemptions (a, c and d and for the two new ones).

In order for exemptions to be fairly applied across settlement instructions and not break immunization principles, two criteria's must be matched: Uniform application of them across CSDs and unique source of data for their detection.

However, while we want to keep at best immunization rule, these cases should be anticipated to be rare, so acceptable and managed, if necessary, thru bilateral claims process.

Q6 Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which ones can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs? Please provide examples and arguments.

Please provide details regarding the costs for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

First and foremost, France Post Marché in its quality of market association is not the best suited to answer and believes that this topic should be discussed extensively with CSDs as they are best equipped to estimate their system capacities.

By default, France Post Marché expects exemptions to be applied ex ante, to the extent that the exemption can be detected, and an automatic correction process to be applied for penalties ex post in order to limit the appeal process to the maximum, which is a manual process with a very short the timetable that would not allow a large volume to be managed within the allotted time. Manual process would imply manual workload for CSDs, Participants and Participants clients. This being said, France Post Marché believes that minimizing cost should be the first criteria chosen on how to apply exemptions.

As regards the one mentioned in 17) b (*ISIN suspension from trading, such as for example under Article 32(1), Article 52(1), Article 69(2) of MiFID II or Article 40(1) of MiFIR*), France Post Marché is doubtful of the ability to manage it with current resources. Indeed, for determining if a financial instrument is in the scope of penalties, CSDs use the FIRDS database and are required to do so by CSDR since penalties apply as soon as the financial instrument is admitted by a trading venue (ie: exists in FIRDS).

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Thus, for such exemption to be processed, all occurrences of the ISIN concerned need to be removed from FIRDS.

One way to achieve this exclusion could be by setting up a list, maintained and communicated by ESMA, of ISIN codes to be penalized. This list could be used to respond to case such as 17) b. but also 18 i. However, the implementation of such a list will generate costs to develop and access this new database in addition to the FIRDS database.

Q7 For exemptions that can be filtered out in advance, do you think that a CSD would prefer to implement this filter or not? Please also consider the potentially very large number of appeals a CSD might have to deal with and also the costs this will entail. Please justify your response.

Considering that appeals processes are complicated and burdensome for both participants and CSDs, France Post Marché expects that if such a filter can be developed, it would be developed and applied automatically by CSDs. As far as possible, exemptions should be detected upstream, to limit the workload involved in identifying and processing them.

France Post Marché expects T2S and the CSDs to carry out a study into the implementation of filters for these types of exemptions. The costs associated with the implementation of a filter or management only by appeal must be weighed against each other (depending on the frequency of intervention of these exemptions) to make the decision that makes the most economic sense.

We expect some cases to be much more frequent than others, justifying the implementation of the filters.

As a matter of principle, France Post Marché expects the automatic filter solution to be applied by default. However, on implementing these exemptions, the rules must be the same on all CSDs, and filters must be implemented at the same time on all CSDs to avoid inconsistencies.

Q8 Do you agree with ESMA's proposal regarding the circumstances in which operations are not considered as trading? Please specify which cases you agree with and which cases you don't agree with (if applicable). Please justify your answer and provide examples and data where available.

Before focusing on each of the proposed exemptions, FPM would like to highlight two points:

- **The notion of trading**

    We already expressed in our answer to the consultation Paper on Technical Advice on CSDR Penalty Mechanism, our concerns on any introduction of the transaction type in the definition of the penalty rates. Exempting from penalty based on the type of transaction is similar to set a rate at 0, therefore our comments remain the same. Beyond the difficulties of using this type of information (see above), we believe such exclusion from the scope of penalties should be limited. Unlike for MBI where the notion of "not considered as trading" is crucial to apply the requirement only where it is sensible, penalties should mostly be applied evenly since "real trades" often rely on "non trades" (like collateral movements, recalls, lending and borrowing, realignments, portfolio transfers, …) to be able to settle. That is the reason why we do not see the rationale to exempt too extensively. Although indirectly, most of these types of contingent transactions are actually "trades".

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- **The usage of the type of transaction**

Although being the natural way to isolate transactions that may benefit from an exemption of penalties under the "non-trading" reason, this solution presents some drawbacks:

- The type of transaction is a data in the hands of the parties to the transaction and, in accordance with CSDR level 2, is given by the professional client to the investment firm and then vehiculated by both parties downwards. This means that it will be taken as it is and that no change can be operated unless done by the trading parties. Therefore, should it be corrected then the process is starting anew
- The type of transaction is not evenly recognized and processed; the same ISO Code could be fully accepted, accepted under condition or not accepted at all depending on the CSD
- Being required in the allocation / confirmation process, the type of transaction is however not a matching criterion, opening the door to situation where the two settlement instructions do not have the same ISO code and thus the need for CSDs to define a rule
- Having the type of transaction becoming a matching criterion will create other issues: a possible agreement on a type of transaction exempted from penalties but more likely an increase of transactions matched late (beyond the intended settlement date) which will turn into more fails and penalties. Such impact should be carefully assessed in the context of a potential to T+1
- Finally, a distinction based on the type of transaction may have impact each time unitary transactions with different types of transaction are netted in a single one; there will be a need to net separately "in" and "out" transactions.

Therefore, we encourage CSDs / T2S to examine if alternative ways may be implemented in order to apply these new exemptions.

Mobilisation / Demobilisation of collateral

On this point France Post Marché does not object to the ECB proposition in its current scope but considers that beyond this specific case there is no reason to extend the exemption.

Market claims and corporate actions on stock

On Corporate actions on stock, this exemption is already being applied, thus France Post Marché welcomes its official registration through this consultation.

On Market Claim, France Post Marché believes that applying this exemption would break the immunization principle (explanation provided on Q12) thus we do not agree with this proposal.

Technical creation of securities

France Post Marché agrees with this proposal, however it should be noted that the technical process of creation is not harmonized between CSDs, as such for the exemption to be efficiently applied France Post Marché suggest an analysis to harmonize the process of technical creation of securities.

France Post Marché also believes that this kind of exemption would happen very rarely, this type of issue being unlikely to happen.

Creation and redemption of funds units on the primary market

France Post Marché welcomes this proposal since it is an issue the French industry has raised and for which market practices have been established. There has been a will from asset managers to have some shares of funds be admitted to a trading venue in order to increase their visibility in particular towards retail clients. Eventually the volume traded on the market are very low or even inexistent. So that transactions on such financial instruments are on boarded in the penalty regime while relating mainly (solely) primary market. In addition, even on the market, transactions are concluded using the subscription / redemption type of transaction.

We understand ETFs such remain in the scope of penalty but we would like to take the opportunity of this consultation and specifically in relation to ETFs to reiterate our views already expressed in the previous consultation: if we acknowledge that there is no reason to exempt transactions on ETFs from penalties, we strongly believe that there is a real need for fails on ETFs to benefit from a bespoke fail rate due to their specificities.

Realignement operations

The term "realignment" covers at least two kinds of operations:

- The T2S realignment, already exempted.
- A (CSD) participant realignment: when a participant moves a position from one of its CSD accounts to another CSD account, most of the time in order to facilitate the settlement and avoid lack of securities, namely when the party and / or the counterparty have not put in place cross CSD settlement process in the respective IT systems.

In case the realignment settles after the ISD, the party who pays the penalty is the one that receives it. The penalty mechanism here, stricto sensu, doesn't have any impact, but only incurs cash flows and reconciliation "noise".

Even if the participant realignment does not reflect a trading, we assume that the implementation costs of such an exemption would be very high, given that penalties apply at instruction level. In this sense it might not be a priority and rather a "nice to have".

In any case, under any scenarios, this exemption wouldn't break the immunization principle.

Q9 ESMA would like to ask for the stakeholders' views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the circumstances in which operations are not considered as trading). Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

Like for the first type of exemption (Q2), we didn't make any quantitative assessment and as regards qualitative one we remain at a high level. The benefits and the costs mentioned in Q2 are also valid for the second type of exemption. However, there is a difference that deserves to be addressed. Unlike for "not attributable to participant" penalties where the frequency and/or the volume may be low, the "not a trading" exemption may apply to huge volumes and in addition may imply significant development since the filter will be based on the type of transaction. Therefore, the costs may be higher.

Again, we consider implementation of new rules for detection, determination will impact any penalties engine manage by infrastructures and participants which have implemented their own penalties computation, replication mechanism. It could also have impact on market data side by considering some new information to be implemented, communicated, and stored for usage.

Q10 Do you have other suggestions regarding circumstances in which operations are not considered as trading? Please justify your answer and provide examples and data where available.

While France Post Marché does not have other suggestions of operations that should be exempted from penalties under the "non-trading" exemption, France Post Marché believes that, as regards buy-ins, several types of transactions should be exempted. For example (as stated in our answer to the European Commission consultation (Review of regulation on improving securities settlement in the European Union and on central securities depositories, Feb 2021):

Markets operations which are distinct from a transaction in a financial instrument, with at least:

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

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

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

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Q11 If you have answered yes to the previous question, please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

Q12 Do any of the exemption proposed above breaks the immunization principle? Please provide arguments.

As indicated in our answer to Q5, the "immunization principle" is a key element for a penalty mechanism to be considered fair, be well-accepted and at the end be a key driver for an improvement of the settlement efficiency. This is with this fundamental point in mind that FPM has analyzed the exemptions proposed by ESMA in its consultation paper. Indeed, a transaction is rarely fully isolated but rather part of a set of investment decisions. Therefore, its successful settlement relies on the settlement of other transactions. As of today, there is a quite full equivalence between a "chain of fails" and its underlying "chain of penalties". Introducing penalty exemptions will negatively impact in this equivalence and accordingly will create a breach of the immunization principle.

As example, we consider market claims penalties exemption may breach immunization principle.

Such settlement flows are issued from standard instructions, impacted by a corporate event, with generation of additional settlement instructions having dedicated settlement cycle. Settlement of the market claim should allow other instructions to settle correctly. Those market claims must be considered and included in the global settlement chain.

Removing from penalties market claims would lead to breach the penalties chain, leading to incorrect penalization of a participant: while he is not responsible of the reason of fail of his instruction, he would support a penalty, which will not be compensated by one coming from the market claim.

Q13 Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which one can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs?

Please provide details regarding the cost for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

The feasibility of an ex-ante filtering must be discussed with CSDs directly (see Q6). We believe that those exemptions might occur more often than the one mentioned in paragraph 17) and 18) of the consultation, thus the ability to filter those exemptions automatically would provide significant savings.

In case of exemption mentioned on point 19) a. France Post Marché believes that the exemption could be applied by filtering for the recipient of the transaction being a Central Bank only.

In the case of exemption mentioned on point 19) d. France Post Marché believes that the exemption criteria cannot only be filtered automatically on the base of the transaction type, as not all funds would be exempted (ETFs remain in scope). As such the type of transaction cannot be the only criteria for filtering but be completed by the type of financial instrument. An alternative could be to use a list of "in-scope" ISINs ESMA would maintain. Like for some exemptions under the "not attributable to

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participant" type, this may ease the process of detection, that will be limited to the existence in the list. It will also help apply a uniform regime to these funds. Indeed, with the current proposed exemption, operations (for example a portfolio transfer) that are not a subscription or a redemption will be penalized should they fail to settle.

Q14 For exemptions that can be filtered out in advance, do you think that a CSD would prefer to implement this filter or not? Also considering the very large number of appeals they might have to deal with and also the costs it will entail.

Considering that appeals processes are complicated and burdensome for both participants and CSDs, France Post Marché expects that if such a filter can be developed, it will be applied automatically by CSDs. As far as possible, exemptions should be detected upstream, in order to limit the workload involved in identifying and processing them.

France Post Marché expects T2S and the CSDs to carry out a study into the implementation of filters for these types of exemption. The costs associated with the implementation of a filter or management only by appeal must be weighed against each other (depending on the frequency of intervention of these exemptions) in order to make the decision that makes the most economic sense.

We expect some cases to be much more frequent than others, justifying the implementation of the filters.

As a matter of principle, France Post Marché expects the automatic filter solution to be applied by default. However, on implementing these exemptions, the rules must be the same on all CSDs, and filters must be implemented at the same time on all CSDs to avoid inconsistencies.

Q15 Which transaction types based on the codes allowed by T2S (or potentially other codes such as ISO transaction codes) should be exempted from settlement discipline measures? Please provide the codes, their definition and arguments to justify the exemption.

Exempting transactions based on ISO transaction codes seems complicated, as they are not applied uniformly across market participants and CSDs. Depending on CSDs the use of the type of transaction is not applied uniformly. Furthermore, the transaction type information is defined by the transaction parties then passed on along the custody chain and is not changed down the line.

In order to use transaction codes as filters for exemption it would be imperative for transactions codes to be harmonized at EU level.

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