THE SCOPE OF CSDR SETTLEMENT DISCIPLINE

ESMA'S CONSULTATION

AMAFI's answer

AMAFI is the trade association representing financial markets' participants of the sell-side industry located in France. It has a wide and diverse membership of more than 170 global and local institutions notably investment firms, credit institutions, broker-dealers, exchanges and private banks. They operate in all market segments, such as equities, bonds and derivatives including commodities derivatives. AMAFI represents and supports its members at national, European and international levels, from the drafting of the legislation to its implementation. Through our work, we seek to promote a regulatory framework that enables the development of sound, efficient and competitive capital markets for the benefit of investors, businesses and the economy in general.

AMAFI welcomes the opportunity to respond to this consultation on the scope of CSDR settlement discipline. Indeed, AMAFI members are very active in the primary and secondary financial markets, notably on bonds equities or ETFs, and they have a strong interest in the effective and fair application of settlement discipline measures. In preparing this response, AMAFI has closely coordinated with France Post Marché and broadly supports their observations and positions.

I. GENERAL OBSERVATIONS

Before answering the specific questions of the discussion paper, AMAFI would like to make the following general observations:

Adjusting Settlement Discipline for the Transition to T+1

The EU is seriously envisaging the shortening of its current settlement cycle from T+2 to T+1. Therefore, the revised rules on settlement discipline (penalty and buy-in) should consider this specific context: ESMA should adopt a coherent approach for the reform of the CSDR penalty regime and the transition to T+1.

The shortening of the settlement cycle is likely to cause a higher volume of settlement issues, at least in the short term, which will be met by higher penalties especially for bonds and ETFs.

Therefore, we call for the suspension of the CSDR penalty regime once T+1 is implemented. The suspension should last at least three months but may need to be extended given the current situation of settlement fails in the EU.

Moreover, irrespective of the suspension period, it should be envisaged to put in place a more granular regime taking into account the specificities of the various asset classes. Especially for ETFs and corporate bonds for which the starting date of calculation of penalties could be set up at T+2.

Ensuring Fairness and Effectiveness in Settlement Discipline

We believe the penalty system should aim to continue to improve settlement efficiency while ensuring fairness. Penalties should target the right parties and not those affected by others' actions. Transactions are often part of a larger set of investment decisions, so any new exemptions need to be carefully considered to avoid disrupting the balance between settlement failures and penalties.

While some proposed exemptions seem reasonable, their implementation should be carefully evaluated for cost-effectiveness. Automated solutions should be used only if they are affordable and practical, with the appeal process as a last resort.

Lastly, we want to clarify that penalties and mandatory buy-ins should be treated separately. Penalties address missed settlement dates, while mandatory buy-ins are a separate measure that overrides the original transaction. We support focusing on the immunisation principle now and advocate for clearer separation of these measures in future regulations.

We hope our feedback helps ESMA refine the exemption framework, and we are ready to engage in further discussions on this matter.

II. AMAFI'S ANSWERS TO ESMA'S QUESTIONS

3.3.1 - UNDERLYING CAUSES OF SETTLEMENT FAILS THAT ARE CONSIDERED AS NOT ATTRIBUTABLE TO THE PARTICIPANTS IN THE TRANSACTIONS

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.

AMAFI welcomes the four proposed exemptions outlined in the consultation, as they provide necessary regulatory clarity by formally including points that have previously been addressed in ESMA's FAQs.

While these additional cases are justified, it is essential to ensure that their implementation does not lead to unintended difficulties or side effects, such as the need for manual actions or modifications to instructions (please refer to our response to question 6 for further details).

Additionally, with regard to the exemption mentioned in point 18(ii) — specifically, "*settlement instructions put on hold due to the order issued by a court, the police or similar authority with a relevant mandate*" — further clarification is needed on the scope of this exemption. For example, would cases

involving sanctions and embargoes on individuals and countries, as mandated by such relevant authorities, also fall under this exemption?

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.

AMAFI has not conducted a quantitative assessment of the costs and benefits related to the implementation of these exemptions. However, we believe that the introduction of new rules for the detection and determination of exemptions will have an impact on penalty mechanisms managed by both infrastructures and participants that have implemented their own systems for penalty computation and replication. Additionally, there could be an effect on the management of market data, as new information may need to be incorporated, communicated, and stored for future use.

One benefit of formalising these exemptions is that it would provide clarity and certainty, either by preventing penalties or by simplifying the appeal process.

If exemptions are applied "ex-post," it would provoke more appeals and require increased manual and operational intervention throughout the process, all within the limited timeframe allowed for appeals (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.

AMAFI does not currently identify any additional cases or events that could be considered for exemption beyond those already proposed.

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.

N/A

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

To ensure the proper functioning of the penalty mechanism, the immunisation principle must be preserved. This principle could be compromised if exemptions are not applied uniformly across all failing instructions, which could be the case with exemptions (a), (c), (d), and the two new ones.

For exemptions to be fairly applied and to maintain the immunisation principle, they must meet two criteria: **uniform application across all CSDs** and **reliance on a single source of data for detection**.

While it is important to preserve the immunisation rule as much as possible, such cases are expected to be rare and could therefore be considered acceptable. If needed, they could be managed through a 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.

AMAFI recognises that determining which exemptions can be filtered automatically (ex-ante) or handled after the fact (ex-post) via the existing appeal mechanism should be carefully discussed with Central Securities Depositories (CSDs), who are best positioned to assess their system capabilities and limitations.

By default, AMAFI expects that exemptions should be applied ex-ante wherever possible, provided the conditions for the exemption can be detected automatically. This approach would minimise reliance on the ex-post appeal process, which is inherently manual, time-consuming, and constrained by tight deadlines, making it challenging to manage a high volume of cases effectively. The manual appeal process would increase operational workloads for CSDs, participants, and their clients. Therefore, minimising costs should be the guiding principle for deciding how to apply exemptions.

For example, concerning exemption 17(b) (related to ISIN suspension from trading, under regulations like MiFID II and MiFIR), AMAFI has concerns about the feasibility of managing this exemption within the current system capabilities. Given that CSDs use the FIRDS database to determine if a financial instrument falls within the scope of penalties—as required by CSDR—penalties apply as long as the instrument exists in FIRDS. Therefore, to apply such an exemption, all instances of the relevant ISIN would need to be removed from FIRDS, which may not be practical.

One potential solution could be for ESMA to establish and maintain a list of ISIN codes subject to penalties, which could address exemptions like 17(b) and 18(i). However, implementing such a list would create additional costs related to developing and accessing a new database, alongside the existing FIRDS database.

AMAFI strongly suggests that any decision regarding the implementation of exemptions consider the balance between efficiency and cost, with a preference for automated solutions wherever possible to minimise the need for manual interventions.

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 the complexity of the appeals process for both participants and CSDs, AMAFI believes that if a filter can be developed to automatically apply exemptions, CSDs would likely prefer to implement it. Exemptions should be detected as far upstream as possible to reduce the manual workload and operational burden involved in handling and processing appeals.

AMAFI recommends that T2S and CSDs conduct a thorough study on the feasibility and costs of implementing such filters for different types of exemptions. The decision to implement a filter or manage exemptions solely through the appeal process should be based on a cost-benefit analysis, taking into account the frequency of these exemptions. More frequent cases would justify the upfront investment in developing automated filters, as this would be more cost-effective in the long run.

As a general principle, AMAFI expects automatic filtering solutions to be the default approach. However, it is essential that these filters are applied consistently across all CSDs, and that implementation occurs simultaneously to avoid any discrepancies or inconsistencies in the application of exemptions across the market.

3.3.2 - CIRCUMSTANCES IN WHICH OPERATIONS ARE NOT CONSIDERED AS TRADING

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 commenting on each proposed exemption, AMAFI would like to highlight two overarching points:

1. The Notion of "Trading"

As stated in our response to the consultation on Technical Advice on the CSDR Penalty Mechanism, AMAFI has concerns regarding the introduction of transaction types into the definition of penalty rates. Exempting transactions based on type effectively sets the penalty rate to zero, which we believe should be limited. Unlike the MBI, where "not considered as trading" is crucial to apply requirements appropriately, penalties should generally be applied consistently. This is because "real trades" often depend on "non-trades" (such as collateral movements, recalls, lending and borrowing, realignments,

and portfolio transfers) for settlement. Therefore, overly broad exemptions are not justified, as most of these contingent transactions are, even indirectly, connected to actual trades.

2. Use of Transaction Type for Exemptions

While using the transaction type may seem like a straightforward way to identify transactions eligible for exemption under the "non-trading" category, this approach presents several issues:

The transaction type data is provided by the professional client and conveyed through the chain. It cannot be changed without starting the process anew, leading to rigidity.

The recognition and processing of transaction types are inconsistent across CSDs; the same ISO code may be accepted, conditionally accepted, or rejected depending on the CSD.

Although required during the allocation/confirmation process, transaction type is not a matching criterion, which could lead to mismatches in settlement instructions, requiring CSDs to establish specific rules.

Making the transaction type a matching criterion could create additional problems, such as an increase in late-matched transactions and more fails and penalties. This impact should be thoroughly assessed, especially in a potential shift to T+1.

Additionally, when unitary transactions with different transaction types are netted into a single one, there would be a need to separate the "in" and "out" transactions, adding further complexity.

Therefore, we encourage CSDs and T2S to explore alternative methods for applying these new exemptions.

- **Mobilisation/Demobilisation of collateral :** AMAFI supports the ECB's proposal for this exemption as currently defined but sees no need for its extension beyond this scope.

- **Market claims and corporate actions on stock:** We support the formalisation of the exemption for corporate actions on stock, as it is already in practice. However, we oppose the exemption for market claims, as it could undermine the immunisation principle, as explained in our response to Q12.

- **Technical creation of securities:** While we agree with the proposal, we note that the technical processes for creating securities are not standardised across CSDs. We recommend analysing and harmonising these processes to apply the exemption effectively. We also believe such exemptions would be rare.

- **Creation and redemption of fund units on the primary market:** We support the proposal for this exemption, recognising it as a valid response to concerns raised by the French industry. Asset managers have sought to list some fund shares on trading venues to enhance their visibility, especially to retail investors. However, the trading volumes for these instruments are typically very low or negligible, making their inclusion in the penalty regime mostly relevant to primary market activities, where transactions are conducted through subscription/redemption

processes. We reiterate our position from previous consultations that while ETF transactions should not be exempt from penalties, they should have a tailored regime due to their specific characteristics.

- **Realignment operations:** "Realignment" can refer to two types of operations: T2S realignments (already exempted) and participant realignments (when a participant moves a position between their own CSD accounts to facilitate settlement and avooid 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). While participant realignments are not “trades,” the costs of implementing an exemption may be very high since penalties are applied at the instruction level. Thus, while an exemption could be beneficial, it is not a priority and would be more of a "nice to have." In any case, under any scenarios, realignments exemption do not breach the immunisation 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.

AMAFI has not conducted a quantitative assessment of the costs and benefits for these exemptions and maintains a high-level qualitative perspective. The considerations from our response to Question 2 apply here as well. However, there is a notable distinction: unlike exemptions related to "not attributable to participants," which may involve relatively low frequency or volume, the "not a trading" exemptions could impact large volumes and require substantial development. This is because filtering will be based on transaction types, potentially increasing the associated costs.

We believe the implementation of new rules for detection and determination will likely affect penalty engines used by infrastructures and participants, particularly those with their own penalty computation and replication systems. Furthermore, it may impact market data management, as new information would need to be integrated, communicated, and stored.

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.

AMAFI does not propose additional operations for exemption under the “non-trading” category beyond those already discussed. However, we believe that several types of transactions related to buy-ins should be considered for exemption, for example :

Markets Operations Distinct from a transaction in a Financial instrument, with at least :

- Collateral management Operations, including transfers.
- Corporate actions, including market claims which are also markets operations distinct from a transaction in a financial instrument.

- Settlement instructions where the party acts as principal for both 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.

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.

N/A

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

As highlighted in our response to Question 5, the immunisation principle is fundamental to ensuring that the penalty mechanism is fair, widely accepted, and effective in improving settlement efficiency. This principle is based on the premise that a transaction is rarely an isolated event but rather part of a series of investment decisions, with its successful settlement often reliant on the settlement of other related transactions. Currently, there is a strong correlation between a "chain of fails" and its corresponding "chain of penalties." Any introduction of penalty exemptions could disrupt this balance, thereby undermine the immunisation principle.

For instance, exempting market claims from penalties could potentially breach the immunisation principle. Market claims often arise from standard instructions impacted by corporate events, resulting in additional settlement instructions with their own dedicated settlement cycles. The settlement of a market claim should facilitate the proper settlement of other related instructions. Excluding market claims from penalties could disrupt the penalty chain, leading to unfair penalisation of participants. Specifically, participants might face penalties for failures that they did not cause, without any corresponding compensation from the market claim penalties. This misalignment could undermine the fairness and effectiveness of the penalty mechanism, breaching the immuniation principle

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.

Ex-ante filtering, which is applied before penalties are imposed, is feasible for exemptions involving transactions with Central Banks (point 19(a)). This type of automated filtering can be cost-effective and efficient, reducing administrative overhead and ensuring timely application of exemptions.

However, for exemptions based on specific transaction types and financial instruments (point 19(d)), automated filtering is more complex. Not all exempt funds, such as ETFs, would be excluded based solely on transaction type. Instead, filtering should consider the type of financial instrument, potentially using a list of "in-scope" ISINs maintained by ESMA. This approach would streamline the detection process by focusing on the instruments listed and ensure consistent application of exemptions.

Overall, ex-ante filtering is likely to be more efficient and less costly compared to managing exemptions through the ex-post appeal mechanism, as it addresses potential issues before penalties are applied, reducing administrative efforts and potential delays.

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.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.

AMAFI believes CSDs would likely prefer to implement automated filters for exemptions if possible. This approach would help manage the high volume of appeals more efficiently and reduce associated costs.

Automated filters can handle exemptions proactively, which would ease the administrative burden and avoid delays compared to manual processing. If filters are feasible, CSDs would benefit from their implementation

We recommend that T2S and CSDs assess the feasibility and costs of these filters. The decision should weigh the costs of implementing filters against managing exemptions through appeals. Automated filtering should be the preferred method where it makes economic sense, and all CSDs should adopt these filters simultaneously to ensure consistent application.

Q16: 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 is challenging due to inconsistent application across market participants and CSDs. The categorisation of transaction types can vary by CSD, and these codes are typically defined by the initiating participant, making uniform application problematic.

To effectively use transaction codes for exemptions, EU-wide harmonisation of these codes would be necessary. Without standardisation, applying exemptions based on transaction codes could lead to inconsistencies and confusion.

Thus, while the idea of using ISO codes for exemptions is conceptually feasible, practical implementation would require a unified approach to transaction coding at the EU level to ensure consistency and fairness across all CSDs.