FINANCE FINLAND

1.2.2021

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European Commission Unit C2

TARGETED CONSULTATION DOCUMENT

REVIEW OF REGULATION ON IMPROVING SECURITIES SETTLEMENT IN THE EUROPEAN UNION AND ON CENTRAL SECURITIES DEPOSITORIES

1. CSD AUTHORISATION & REVIEW AND EVALUATION PROCESSES

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

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

Current CSD pass-porting arrangements require approval from the relevant NCA for the market into which the CSD would like to provide its services. IF a CSD wants to provide services in multiple markets, it will require multiple approvals which may differ in criteria from country to country. The differing application of CSD rules directly impacts the cross-border provision of services which ultimately serves as a barrier to the Union's single market ambitions. A **college of supervisors** would provide consistency, avoid regulatory arbitrage and promote competition.

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

Finance Finland supports Recommendation 16 of the CMU Action Plan which argues for the continued 'strengthening' of ESMA's scope and development of a 'single-rulebook'. Supervisory convergence across the Member States will reduce the administrative burden on CSDs, enable equivalence and will help to further develop harmonised Union level supervision and risk management of national and regional infrastructure.

It is very important to ensure ESMA has adequate resources, so the processing of answers is not impeded. A single rulebook does not apply to all circumstances, because market structure varies between EU states. An example of this are account structures: ESMA gives guidelines through nominees, but Finland uses a direct account structure and therefore must interpret and adapt the guidance before use.

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?

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- Yes

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

We have only one CSD in Finland, so there has been no competition that would have affected cost levels. The reasons why there are only one CSD are e.g.:

- national requirement of direct account structure
- the harmonization of dealing with corporate actions is partly inadequate
- processes related to taxation differs between EU states

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

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

Current CSD pass-porting arrangements require approval from the relevant NCA for the market into which the CSD would like to provide its services. The differing application of CSD rules is a barrier for the provision of cross-border services. This is especially relevant where a CSD wishes to provide services in multiple markets as it will be required to obtain multiple approvals which may differ in criteria. A college of supervisors would provide consistency, avoid regulatory arbitrage and promote competition. In order to ensure a fair and competitive level playing field we view single supervision as a prerequisite for more integrated EU capital markets.

3. INTERNALISED SETTLEMENT

Question 15. Article 2 of Commission Delegated Regulation (EU) 2017/391 establishes the data which internalised settlement reports should contain. Do you consider this data meets the objectives of relevance, effectiveness, EU added value, coherence and efficiency?

-Yes

Question 15.1: Please explain your answer to Question 15, providing where possible quantitative evidence and/or concrete examples.

There are lots of duplicate reporting to different authorities and other users (ECB, ESMA, local supervision authorities, Statistics). An EU-level database for reporting requirements could be a solution to harmonize reporting. If required data is downloaded invariable to only one database in the same format and with the same content, it would reduce workload for the reporting entities and the users of data, and authorities as well as other users of data could access the data needed with their own query tools.

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Question 15.2: If you are an entity falling under the definition of "settlement internaliser", what have been the costs you have incurred to comply with the internalised settlement reporting regime? Where possible, please compare those costs to the volumes of your average annual activity of internalised settlement.

Reporting requirements should be stable over time, to implement new reporting requirements increases workload and is costly.

Question 16. Do you think that a threshold for a minimum level of settlement internalisation activity should be set for entities to be subject to the obligation to report internalised settlement?

- No

Question 16.1: Please explain your answer to Question 16, providing where possible quantitative evidence and/or examples. Please indicate:

- whether you consider that the introduction of such a threshold could endanger the capacity of NCAs to exercise their supervisory powers efficiently;

Finance Finland does not support the introduction of thresholds on national or EU level.

The introduction of any threshold would imply a dedicated monitoring and the consequent activation/deactivation of the relevant internalised settlement reporting (upon overtaking the threshold) which would make the process more complex to manage and run, compared to the current set-up where internalisers report all their internalisation activity, regardless its level/dimension.

The relevant supervisory NCA of an entity overtaking from time to time or seasonally the internalization thresholds, would see the relevant data reporting coming in only when the thresholds would be overtaken, and it would likely end in having a more fragmented view of the overall settlement internalization run in a certain market, compared to what an NCA can currently observe.

4. CSDR AND TECNOLOGICAL INNOVATION

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5. AUTHORISATION TO PROVIDE BANKING TYPE ANCILLARY SERVICES

Question 24: Concerning settlement in foreign currencies, have you faced any particular difficulty?

- Yes

Question 24.1 Please explain your answer to question 24 providing concrete examples and quantitative evidence.

Revenue payments require foreign currencies (other than €), and for instance national holidays may cause problems because opening days of currencies differs from country to country.

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6. SCOPE

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?

- Yes

Question 31.1 If you answered "yes" to Question 31, please specify what clarifications/targeted measures could provide further legal certainty.

Finance Finland is of the view, that the scope of settlement discipline should be clarified to avoid complicated interpretation.

Additional clarity on the scope of application of the following requirements under CSDR would provide further legal certainty, which

- legal entities
- securities
- type of transactions

fall under reporting obligations and the settlement discipline rules.

Scope of Legal entities: CSDR art 7(10) point (i) of the first subparagraph is referred to in Article 1 (f), when defining a trading party as a party acting as a principal in a securities transaction. A principal is defined neither in the level 1 nor 2 text, and the lack of an exact definition of a principal, confuses the stakeholders when implementing CSDR-penalty regime. The article 7 should be amended to clarify that buy-in obligations and penalties apply only to regulated entities, excluding retail customers and non-professional investors. The settlement discipline rules in Articles 6 and 7 of the regulation clearly places regulatory obligations on CSDs, CCPs, trading venues and investment firms, all of which are regulated entities. Article 30 of the delegated regulation seems to widen the scope of the regulation as obligations are placed on “trading parties”, defined as “a party acting as principal in a securities transaction”. This definition is somewhat ambiguous, but it could be interpreted as the end investor, who may be a regulated or non-regulated legal entity, or as an SME or private individual. Most SMEs or private individuals do not have the competence or the resources to comply with the obligations in the buy-in rules. Our finding is that this ambiguity has an impact on certain types of transactions when it comes to buy-in processes for transactions not cleared by a CCP and not executed on a trading venue.

Scope of which securities fall under the settlement discipline rules and reporting obligations should be defined more clearly. It could help market participant, if ESMA or some other authority had an official, updated list of trading venues share listing that fall under settlement discipline rules.

Scope of transactions subject to buy-ins: Buy-in obligations should apply only to **transaction types purchase and sale of securities on secondary market**. Internal transactions, primary market transactions, portfolio transfers without change of beneficial owner and collateral management recordings should be excluded. For

clarification and harmonization of the transaction types, CSDR delegated regulation Article 5(4)(a) should be amended on level 2 or 3.

Cash movements in and of themselves at CSDs, such as market claims in cash, and penalties for late payments, should be explicitly excluded from the penalty regime.

Concrete examples of transactions that should be considered out of scope of the buy-in requirements (Art. 7.3)

1) **Settlement instructions related to the outcome of trading:**
   - Trading flow such as collateral and margin
   - activity relating to the holding of securities purchased by the trading party such as corporate actions
   - Flow supporting settlement such as depot realignments
   - Flow relating to transfer of activity from one custodian to another such as portfolio transfers or transitions

2) **Settlement instructions that have existing contractual mechanisms in place:**
   - Securities repurchase or lending transactions and derivative contracts

3) **Primary market transactions**

A buy-in would serve no economic purpose, nor would it contribute towards improving the efficiency of securities settlement.

Question 31.2 If you answered "yes" to Question 31, please specify which provisions could benefit from such clarification and provide concrete examples.

We are of the opinion that further clarification is needed that buy-in obligations only be imposed on **regulated entities**. We suggest that the definition of “trading party” in the RTS is changed to mean the regulated entity closest to the end investor or other principal at the end of the chain.

Retail customers or non-regulated entities (e.g., SME) may end up being the trading party that does not receive the securities and therefore would need to carry out a buy-in and thereby must appoint a buy-in agent as well as to calculate the cash compensation amount if a buy-in is not possible.

We would like to illustrate this with examples:

1) A transaction to sell/purchase securities takes place bilaterally between two non-regulated customers. The two non-regulated customers hence become the “trading parties” and instruct their respective custody banks to settle the transaction.
2) A transaction, such as an agreed securities transfer between two retail customers (e.g., inheritance, gift), may lead to that two retail customers become the “trading parties” and they provide instructions to their respective custody banks about the transfer.

Even if prolonged settlement fails in the above-described situations only occur very infrequently, they will be of great concern for the responsible parties when

they do occur and will have the custody bank update its customer agreements, processes and customer support activities to live up to the situation.

Question 32. Do you consider that the scope of certain requirements, even where it is clear, could lead to unintended consequences on the efficiency of market operations?

- Yes

Question 32.1 If you answered "yes" to Question 32, please specify which provisions are concerned.

Finance Finland is of the opinion that the buy-in regime should be changed from a mandatory obligation to a voluntary option on other than CCP-cleared transactions. If we have a well-functioning penalty regime, there is no need for mandatory buy-in regime. The purchasing party's right to use buy-in as an optional right, secures the purchasers legal rights.

It should be clarified that the buy-in option only applies to **regulated entities** on trading level, excluding e.g. retail customers, SMEs, entities on CSD level and intermediaries in the chain:

- a retail customer does not have the competence or resources to comply with the buy-in obligations
- a retail customer is not likely to have its own agreement with a buy-in agent in advance, and
- if the Bank is to appoint the buy-in agent on behalf of the retail customers, this will come at a cost for the customer, who is also very likely to be required to provide collateral.

Uncertainty regarding the rules and role of the buy-in agent
The function of a buy-in agent is not clear. According to the RTS, and depending on the type of transaction, either the CCP or the receiving trading party shall appoint a buy-in agent to execute the buy-in when a buy-in is possible. The buy-in agent shall not have any conflict of interest in the execution of the buy-in, it is unclear which type of entities can take the role as a buy-in agent:

- is it possible to set-up bilateral agreements between two competitors/financial institutions to take on the role as buy in agent for each other for all or certain securities?
- how to proceed with a buy-in if there is no agent available for certain markets or securities.

At present there is not a single buy-in agent that covers all securities that would fall under the buy-in obligation, which leads to the use of different processes for buy-ins depending on if there is coverage by agents for all markets or securities or not. This can lead to market inefficiencies.

Parallel systems for collection and distribution of penalties

The SDR RTS Article 19 may result in the existence of two parallel systems for the collection and distribution of penalties for failed settlements, provided by CSDs and CCPs respectively which would be complex and inefficient leading to additional administrative burden and costs for all trading parties.

Provision of market maker services
In a well-functioning market, a market maker provides liquidity to the market throughout the day and liquidity is relatively stable over time. The market maker plays an important role for less liquid instruments when providing buy and sell prices to investors for securities where it is not possible to simultaneously meet opposite interests.

The market maker regularly provides sell prices without holding the securities. If an investor buys securities that the market maker does not hold, the market maker covers the short position by searching for a seller. If the market maker would need to consider the cost, time, and administrative procedures for having to execute a potential buy in, if he does not himself receive the securities he just sold to the investor, there is a risk that he would no longer want to remain a market maker for illiquid securities as the attached risk and cost related to having to execute a potential buy-in are difficult to estimate. Also, if the market maker needs to ensure that he already holds the securities for which he quotes a price he would have to reduce the number of securities for which he acts as a market maker due to the high cost of capital requirements for holding less liquid securities in the trading book.

To compensate for the cost of holding securities in the trading book he would also need to quote less aggressive prices. Hence there is a substantial risk that mandatory buy-in requirement on illiquid instruments would lead to a reduction in market liquidity as well as to a deterioration in price formation for those instruments and thereby to less efficient secondary markets. As the functioning of secondary markets has a direct impact on the functioning of primary markets it could even lead to higher financing costs for small and medium issuers as market liquidity of the related securities is generally lower than for larger issuers.

Question 32.2 If you answered "yes" to Question 32, please specify what targeted measures could be implemented to avoid those unintended consequences while achieving the general objective of improving the efficiency of securities settlement in the Union?

Parallel systems for collection and distribution of penalties
We propose, in line with the proposal by EACH, a deletion of SDR RTS Article 19 and that SDR RTS Article 17 is applied consistently for all transactions.

Provision of market making services
We suggest that illiquid securities are exempted from the mandatory buy-in requirements.

7. SETTLEMENT DICIPLINE

Question 33: Do you consider that a revision of the settlement discipline regime of

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CSDR is necessary?

-Yes

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
- Other

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

Finance Finland supports EBFs view that the obligation on the part of investment firms to confirm receipt of the written allocation under Article 2(2) of RTS should be removed.

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	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[1]					X	
The rules on the use of buy-in					X	

[1] E.g. a mechanism providing that where a settlement fail is the cause of multiple settlement fails through a transaction chain, it should be possible for a single buy-in to be initiated with the intention to settle

agents should be amended						
The scope of the buy-in regime and the exemptions applicable should be clarified					X	
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.

Finance Finland supports a common settlement discipline regime for the EU to achieve harmonisation in this area and welcomes the single set of rules put forward by the CSDR. However, there are some rules in the CSDR settlement discipline regime that would give more clarity if they were written more specific.

We also believe that the texts of Level 1 and level 2 should be harmonized for more consistency; level 1 text should be setting principles and high-level requirements, and not covering details of operational processes.

We are of the opinion that mandatory buy-ins should be made voluntary to a certain category of transactions and securities

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Rules relating to buy-ins: mandatory obligation should be removed, and it should be an optional right for the purchaser to execute a buy-in when the buyer is not a CCP. For CCP-cleared transactions, we retain that existing CCP mandatory buy-in rules should remain in place.

This would protect the rights of the purchaser, without enforcing an action that may be against the buyer's commercial or economic interests.

Generally, we are concerned about the negative effects that mandatory buy-ins could have on securities markets, at least in certain situations, as described in section 6 (questions 31.1, 31.2 32.2 “Provision of market making services”). Also, in certain situations the buyer of the security might prefer not to receive the security and it would be more suitable if the receiver would have the option to do a buy-in and not the obligation. Hence, although there are advantages with common buy-in rules, it should be voluntary for the buyer to use his right to proceed to a buy-in.

Uncertainty regarding the buy-in agent rules and role
Please see answers to questions 32.1 & 32.2 and “Uncertainty regarding the rules and role of the buy-in agent”.

The scope of the buy-in regime
Please see answers under section 6.

The asymmetry in the reimbursement for changes in market prices should be eliminated

When a buy-in is executed, the asymmetry in the reimbursement for changes in market prices should be eliminated (see paragraph 6). Such deletion would also provide for more consistency of the level 1 text with level 2.

Penalty rate revision
The article 7 should be amended to clarify that penalties apply **only to regulated entities**, excluding retail customers and non-professional investors. The settlement discipline rules in Articles 6 and 7 of the regulation clearly places regulatory obligations on CSDs, CCPs, trading venues and investment firms, all of which are regulated entities. Article 30 of the delegated regulation however seems to widen the scope of the regulation as obligations are placed on “trading parties”, defined as “a party acting as principal in a securities transaction”. This definition is somewhat ambiguous, but it could be interpreted as the end investor, who may be a regulated or non-regulated legal entity, or as an SME or private individual. Most SMEs or private individuals do not have the competence or the resources to comply with, for example, the obligations stipulated in the buy-in rules. Our finding is that this ambiguity has an impact on certain types of transactions when it comes to buy-in processes for transactions not cleared by a CCP and not executed on a trading venue.

Another reason for excluding Penalties for retail-customers is that there is no nominee-account structure in Finland, which impacts the costs for retail-customers. The cost of collecting penalties from retail-customer is higher than the payments from the retail-customer.

Market participants have already invested in systems aimed at handling the penalty requirements. Therefore, changes to penalty rules that would lead to a systemic impact should be avoided.

Remove certain types of transactions from the penalty regime
Several types of transactions (e.g., Internal transactions, primary market transactions, portfolio transfers without change of beneficial owner and collateral management recordings) should be excluded from the penalty regime. In some cases, the customer is both the payer and the receiver of the related penalty (a customer transferring equities between two custody accounts). Netting out those penalties would reduce unnecessary administration and costs. The same should also be the case for transactions that are supposed to increase settlement efficiency in the market and enable settlement in time, -like securities lending transfers.

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?

- 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.

The settlement efficiency in Finland is high, 98,1%, and did not weaken due to COVID-19 pandemic even though trade volumes were exceptionally high. Market participants focused all their resources to secure the daily market procedures, which led to minimum development of systems to minimize negative impact of COVID-19. It is hard to get data to evaluate the number of buy-in events in different asset classes, if buy-in regulation had been valid.

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.

Please see answers to questions 33 and 34.

We want to highlight, that:

1) **timeline**:-timing should be carefully synchronized and made compatible with the activities already ongoing by the market participants
2) Mandatory buy-in regime should be changed to **a voluntary buy-in regime** on other than CCP-cleared transactions
   - an optional right to the buyer
   - retail customers and other non-professional investors should be excluded
3) **Penalties** for retail-customers and non-professional investors should be excluded, technically this could be achieved by treating them as internal customers. The cost of collecting penalties from retail-customer is higher than the payment from the retail-customer.

4) certain types of transactions should be excluded

8. FRAMEWORK FOR THIRD COUNTRY CSDs

Question 37. Do you use the services of third-country CSDs for the issuance of securities constituted under the law of the EU Member State where you are established?

-Yes

37.1 If you answered "Yes" to question 37, please indicate which services of a third-country CSD you use.

As UK is no longer a member of EU and CSDs in UK provide services of certain securities that are not traded in other markets, some members use third country CDS services for portfolio and liquidity management, trade, settlement and custody services.

Question 42. If you consider that there are other aspects of the third-country CSDs regime under CSDR that require revision / further clarification, please indicate them below providing examples, if needed.

IF there are same regulation and reporting requirements for third country CSDs as for EU CSDs, then the playing field between EU and third country CDSs may be level.

9. OTHER AREAS TO BE POTENTIALLY CONSIDERED IN THE CSDR REVIEW

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