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BVI's position on the ESMA consultation on the Scope of CSDR Settlement Discipline

We¹ gladly take the opportunity to present our views on the ESMA consultation on the scope of the CSDR Settlement Discipline regime. We welcome ESMA's consultation to assess with the market the effectiveness and proportionality of the scope of the CSDR settlement discipline regime.

We support the aim to achieve an efficient, integrated, and safe market for securities clearing and settlement in the EU, particularly for cross-border transactions. Efficient and safe securities settlement systems with an EU wide harmonized scope of the settlement discipline regime will benefit all investors and further promote a pan-European securities market.

Highly regulated investment funds (UCITS/AIF) and asset managers are part of the Buy-Side of wholesale financial services. Buy-Side firms are users of the post trading market infrastructure rather than providers of post trade services (e.g. CCP's, CSD's). The investment fund market in Europe is rather fragmented in terms of trade and post-trade operational models. The value chain of fund investing (primary market; subscription/redemption) and secondary market trading of fund shares (ETFs), settlement, custody and asset servicing usually works very efficiently in local markets in the EU and for most local funds.

German investment fund management companies are not directly involved in the value chain of clearing and settlement of securities transactions. They instruct the custodians of the investment funds to match and settle securities (e.g. equity, bonds, ETFs, fund units) belonging to such investment portfolios. The custodians have a direct access with the CSD's. Investment fund management companies must rely on the information obtained by the custodians to react in cases of settlement fails or Buy-Ins. The custodians must ensure that all relevant settlement information needs to be sent as fast as possible to the fund management companies. This will enable the investment fund management companies to solve all discrepancies for unsettled and failing trades where a decision is required by the custodians from the investment managers. A fast transformation of settlement information from the fund custodian to the asset manager is of utmost importance if the settlement cycle will be shortened to T+1. (Institutional) investors defined as professional clients in MiFID are not involved in the clearing and settlement process of securities transactions. There is only a direct relationship between the fund management company, the counterparty of the transaction (e.g. broker/dealer) and the fund custodian.

AIF and UCITS fund management companies (FMC) (may) delegate primary market and issuing functions Investment funds units and shares to Transfer Agents (TA, transfer agent model) or Issuing Agents (IA). This function may also sit with the asset manager, a depositary bank, or another specialised third-party provider, usually a custodian bank. Markets where a dedicated service provider performs this function, the so-called Transfer Agent (TA), are amongst others the UK and Ireland. In France and Germany

¹ BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.



this function is normally performed by the fund depository/custodian bank, acting also as Issuing Agent for the shares in the national and cross-border CSD's.

The introduction of the CSDR cash penalty regime in February 2022 has not improved the settlement efficiency for the German Buy-Side. According to our observations the main reason for settlement fails are missing securities on the Sell-Side, instructions that are sent too late to the markets or problems with the settlement instructions (SSIs). The introduction of the CSDR cash penalty system has increased the operational burden for the Buy-Side as they have to monitor every penalty of a failed trade which belongs to an investment funds without any additional value for the settlement efficiency.

Some German asset managers have increased their internal resources to handle and to monitor only the cash penalty process thereby, increasing their operational costs without any additional value for the settlement efficiency. Also, some asset managers today use more internal resources to cover the cash penalty process than for the daily settlement discrepancies. In this context, we expect more daily settlement fails for trades, large or small, in the short term in the context of an EU move to T+1. However, at this stage, it is impossible to predict whether the settlement fail rates will be higher over long period of time compared to the current settlement cycle in Europe.

We would like to make the following specific comments to the chapter 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.

- We strongly agree with ESMA's proposal to exempt the creation and redemption of fund units on the primary market, meaning the technical creation and redemption of fund units (except for ETFs) (19d). Within the Germany fund market, the technical subscription and redemption of fund units settle via the fund custodian and the relevant CSD's and can therefore never contribute to any settlement fails. Such an exemption enhances the legal certainty for the asset managers and make the settlement discipline rules better tailored to the diversity of market operations and transactions that can potentially be subject to the regime.
- However we do not agree with ESMA's proposal to exclude free-of-payment (FoP) securities transfers to securities accounts at CSD 's in the context of the (de)mobilisation of collateral (19 (a)). Currently, it is unclear for us which concrete market operations should be considered as FoP transactions in the case of (de)mobilisation of collateral.

If FoP collateral transfer transactions are excluded, there could be a fundamental risk that, for example, in cases of late recalling of a securities lending transaction due to a sale, the cash claiming process vis-à-vis the lending counterparty could no longer be carried out. Both lending instructions and transactions for bilateral collateralization are mainly transmitted as FoP transactions via SWIFT. Exempting FoP security collateral transfers may sometimes break the immunisation principle. Therefore, we encourage ESMA to further clarify what is meant by a free-of-payment security transfer to securities accounts at CSD's in the context of the (de)mobilisation of collateral.



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.

The (technical) exemption of fund subscriptions and redemptions of fund units will improve the legal certainty and the operational efficiency for the asset managers.

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.
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 exemptions proposed above break the immunization principle? Please provide examples and arguments.
Q13: 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.

We have no comments.

Q14: 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.

CSD's should be able to automatically filter out in advance exempted market operations. Such process would significantly enhance the operational efficiency for all involved market participants.

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.

We have no comments.
