Reply Form

**to the Consultation Paper on Technical Advice on CSDR Penalty Mechanism**

Responding to this Consultation Paper

ESMA invites comments on all matters in this Consultation Paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

* respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **29 February 2024.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

• Insert your responses to the questions in the Consultation Paper in this reply form.

• Please do not remove tags of the type < ESMA\_QUESTION\_CSDR\_0>. Your response to each question has to be framed by the two tags corresponding to the question.

• If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.

• When you have drafted your responses, save the reply form according to the following convention: ESMA\_CP1\_CSDR \_nameofrespondent.

For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA\_CP1\_CSDR \_ABCD.

• Upload the Word reply form containing your responses to ESMA’s website (**pdf documents will not be considered except for annexes**). All contributions should be submitted online at *www.esma.europa.eu* under the heading *‘Your input - Consultations’.*

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

**Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘[Data protection](https://www.esma.europa.eu/about-esma/data-protection)’.

**Who should read this paper?**

All interested stakeholders are invited to respond to this consultation paper. In particular, ESMA invites market infrastructures (CSDs, CCPs, trading venues), their members and participants, other investment firms, credit institutions, issuers, fund managers, retail and wholesale investors, and their representatives to provide their views to the questions asked in this paper.

# General information about respondent

|  |  |
| --- | --- |
| Name of the company / organisation | National Association of German Cooperative Banks (BVR); German Savings Banks Association (DSGV) and Association of German Public Banks (VÖB) |
| Activity | Associations, professional bodies, industry representatives |
| Are you representing an association? |  |
| Country / Region | Germany |

# Questions

1. Do you agree with ESMA’s proposal? Which Option is preferable in your view? Please also state the reasons for your answer.

<ESMA\_QUESTION\_CSDR\_1>

As general remarks we would like to reiterarte that we, the National Association of German Cooperative Banks (**BVR**), the German Savings Banks Association (**DSGV**) and the Association of German Public Banks (**VÖB**), representing together more than 1100 banking institutions in the German market, including *Landesbanken*, DZ Bank, savings banks (*Sparkassen*), cooperative banks (*Genossenschaftsbanken*) and promotional banks (*Förderbanken*) – together “**the Associations**”, would like to reiterate our longstanding support of the CSDR Settlement Discipline and policymakers’ ambition to reduce settlement fails in EU securities markets. We consider that the cash penalty mechanism is an appropriate tool for creating behavioral incentives towards settlement efficiency in EU securities markets.

However, the mechanism should minimize complexity. It should be easily understandable for all types of market participants, allowing them to accurately predict net exposure and seeking to minimize the number of appeals or bilateral claims.

The cash penalties regime should create a behavioral incentive for market participants to prevent/remediate settlement fails – i.e. minimize their penalty debits. It should not create an incentive for market participants to seek to maximize their penalty credits, which will have distortive market impacts and undermine settlement efficiency. I.e. when making being failed-to economically more rewarding since the penalties received are so high than the returns from the underlying instrument (no incentive for end buyers to accept partials, shaping, or issue buy-ins), this creates adverse behavioral incentives. Any ideas in this respect necessarily would have to be accompanied by the mandatory increase of the use of partial settlement by mandating that CSDs provide this functionality and market participants accept partial deliveries within certain parameters.

It should also not materially impact trading decisions/broader market liquidity. Too high penalties might lead to pricing impacts which in turn may lead to additional cost for investors in secondary and issuers in primary markets. If this happens, i.e. the penalties are priced into the transaction costs from the outset so that the customer (will) ultimately pay, nothing will be achieved in terms of settlement efficiency.

We are strongly against proposals that significantly alter the methodology for calculating cash penalties – e.g. by varying daily penalty rates according to the length of the fail or notional value of the instruction. This would unnecessarily increase the complexity of the regime whilst also introducing potential distortive impacts. Changes to the methodology would represent another significant multi-year implementation project for market infrastructures and their direct and indirect users. This would divert industry resources away from addressing underlying causes of settlement fails. It would also mean that by the time the changes took effect, the data on which the regulatory decision was made would be significantly out-of-date. A recalibration of penalty rates within the current methodology could be implemented much more quickly.

**Regime for enforcing penalty claims**

In our view, there is a need for a stronger legal foundation for enforcing penalty claims, particularly if a penalty has been erroneously attributed to one party. In the matching process, CSDs have a limited view of who is actually responsible for the delay. At times, adjustments are made to match the counterparty, even if they had provided incorrect instructions. Consequently, the penalty is imposed on the party that did not make the mistake. In the claiming process, reliance is often placed on the market standard set by AFME, making communication with counterparties challenging.

As penalty rates are anticipated to rise, also the importance of instances where penalties are inaccurately assigned rises. This not only poses operational challenges but also raises the legal complexity of successfully pursuing and enforcing penalty claims. Addressing this issue requires a careful examination of the legal framework surrounding penalty attribution and claiming processes to ensure a fair and efficient resolution of penalty-related disputes.

**Comments on the different options proposed by ESMA**

As regards the different options we are of the opinion, that there is actually no need for changing the current approaches as none of the options proposed by ESMA will likely have a measurable impact on the settlement efficiency rates. In particular, the actual occurrences of fails requiring the consideration of cash discount rates (i.e. fails due to “lack of cash” as well as receipts versus payments that are put “on hold”) is very low. Hence, any changes to the penalty regime addressing possible shortfalls in this direction are not fit for purpose. Instead, any options will incur development and/ or maintenance cost for CSDs, T2S and other stakeholders without benefits. Therefore, we do not recommend making any changes.

In more detail:

Option 1 requiring currency conversions represents a totally new approach that would require multiple IT developments. The double currency conversion process (i.e. initial currency to be converted to EUR and back after penalty calculation) requires a completely new IT development (including in T2S) with too high cost for a very small business scenario and almost no benefit.

For Options 1 to 3 to be feasible at all, the actual cash interest rates to be applied by CSDs for their daily penalty calculations would have to be calculated by the Central Banks or ESMA and centrally published and maintained up to date by e.g. ESMA for all stakeholders. This would ensure an efficient process for the same reference data being available to all stakeholder, avoids individual manual rate calculation needs and the subsequent risk of potential errors (e.g. due to day count conventions and other adjustments) when calculating the applicable rates by every single stakeholder.

Finally, we are against Option 4, since it requires the implementation of a completely new system, and the implementation of progressive rates is overly complex. This outweighs the fact that the rates definition and maintenance process seem to be much simpler and transparent, would avoid the need to search, calculate or source, monitor and update the applicable rates for any currency on a frequent basis and is comparable with the existing approach applied for “lack of securities” fails. Finally, the proposed daily rates appear very high and we are concerned that the competitiveness of the EU capital markets could be negatively impacted by the application of overly high (even extreme) daily penalty rates.

<ESMA\_QUESTION\_CSDR\_1>

1. Do you have other suggestions? If yes, please specify and provide arguments.

<ESMA\_QUESTION\_CSDR\_2>

We see no need for changes, please see our response to Question 1.

<ESMA\_QUESTION\_CSDR\_2>

1. Do you agree with the approach followed for the Option you support to incorporate proportionality in the Technical Advice? If not, please provide an indication of further proportionality considerations, detailed justifications and alternative wording as needed.

<ESMA\_QUESTION\_CSDR\_3>

Please see our response to Question 1. We do not see any need for and, therefore, generally oppose any changes to the current system.

<ESMA\_QUESTION\_CSDR\_3>

1. What costs and benefits do you envisage related to the implementation of each Option? 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.

<ESMA\_QUESTION\_CSDR\_4>

|  |  |  |
| --- | --- | --- |
| **Option** |  | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_4>

1. As a CSD, do you face the issue of accumulation of reference data related to Late Matching Fail Penalties (LMFPs), that may degrade the functioning of the securities settlement system you operate? If yes, please provide details, including data where available, in particular regarding the number and value of late matching instructions, as well as for how many business days they go in the past from the moment they are entered into the securities settlement system, and the percentage they represent compared to the overall number and value of settlement fails on a monthly basis (please use as a reference the period June 2022 – June 2023).

<ESMA\_QUESTION\_CSDR\_5>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_5>

1. What are the causes of late matching? How can you explain that there are so many late matching instructions? What measures could be envisaged in order to reduce the number of late matching instructions?

<ESMA\_QUESTION\_CSDR\_6>

Other than according to ESMA´s statement, our data does not indicate that there are “so many” late matching instructions and thus not too many penalties are resulting from them (5% of all penalties). Nevertheless, we would like to elaborate on late matching, whose main cause is that settlement instructions are sent by the participants only after the intended settlement date (ISD). Reasons for late matching include:

Trading level

Some of the reasons for late matchings are related the trading level (transaction mismatches which are only rectified after the intended settlement day, e.g. due to price mismatches, discrepancies on the number of securities).

Late Trades and Cut-Off Times

Late matching often arises from trades executed close to or after cut-off times. In such cases, the delayed confirmation or matching of trade details can lead to challenges in meeting settlement deadlines. Traders or counterparties involved in late trades may struggle to complete the necessary steps within the standard settlement cycle, contributing to late matching scenarios.

Settlement Instructions: Timing and errors

Another contributing factor is the practice of issuing instructions only when the inventory is available. If counterparties wait until they have the necessary securities in their possession before initiating the instruction, this introduces delays in the matching process. This approach may stem from risk mitigation strategies, but it can lead to late matching situations, particularly if the instruction is not promptly matched upon availability of inventory.

In some cases settlement instructions for portfolio transfers are not sent in time or in the required format or contain different ISDs.

Manual Errors

Manual errors in the matching process can also result in late matching. Human errors, such as data entry mistakes or discrepancies in trade details, can lead to mismatches that require manual intervention for resolution. Identifying and rectifying these errors can be time-consuming, contributing to delays in the matching process.

Hence, addressing late matching requires a multifaceted approach, including introducing SSI standards, improving communication and coordination among counterparties, implementing automation to reduce manual errors, and promoting timely instruction issuance practices. By understanding and mitigating the root causes, the industry can work towards enhancing efficiency and reducing the incidence of late matching scenarios.

In addition, the “hold and release” functionality is already available to participants; they can send settlement instructions to CSDs before the ISD even when no sufficient cash/securities are available on ISD to avoid late matching. The extended use of this tool could reduce the occurrence of late matchings unless the reasons for late instructions are outside the control of the CSD participants (e.g. issues/delays occur on trading level).

In this context we, the Associations representing more than 1100 banking institutions in the German banking market would like to point out, that great care must be given when specifying the exemptions under the revised CSDR, e.g. where settlement fails the underlying cause of which is not attributable to the participants in the transaction or operations that are not considered as trading are concerned. It should be made clear that corporate actions as well as market claims resulting therefrom, as well as e.g. subscription and redemption of funds should not be subject to the settlement discipline regime.

As a side aspect, please note that a move to T+1 settlement may result in a material increase of settlement fails – i.e. increases the number of unsettled transactions on the ISD.

<ESMA\_QUESTION\_CSDR\_6>

1. Do you agree with ESMA’s proposal to establish a threshold beyond which more recent reference data shall be used for the calculation of the related cash penalties to prevent the degradation of the performance of the systems used by CSDs? Please also state the reasons for your answer.

<ESMA\_QUESTION\_CSDR\_7>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_7>

1. Do you agree with the threshold of 92 business days or 40 business days in order to prevent the degradation of the performance of the systems used by CSDs? Please specify which threshold would be more relevant in your view:

**a)92 business days;**

**b)40 business days;**

**c)other (please specify).**

**Please also state the reasons for your answer and provide data where available, in particular regarding the number and value of late matching instructions that go beyond 92 business days, 40 business days in the past or another threshold you think would be more relevant, and the percentage they represent compared to the overall number and value of settlement fails on a monthly basis (please use as a reference the period June 2022 – December 2023).**

<ESMA\_QUESTION\_CSDR\_8>

A threshold of 40 settlement days for late matching scenarios should be sufficient. Late matching refers to instances where the confirmation of trade details between counterparties is delayed, typically occurring after the standard settlement cycle. A 40-day limit provides a reasonable timeframe for parties to resolve matching issues without unduly prolonging the settlement process.

In specific cases where the instruction of transactions with a value date more than 40 days in the past is necessary, instructions should be based on current data, and the parties involved should explore alternative means for possible compensation.

<ESMA\_QUESTION\_CSDR\_8>

1. Do you agree that the issuer CSD for each financial instrument shall be responsible for confirming the relevant reference data to be used for the related penalties calculation? Please also state the reasons for your answer.

<ESMA\_QUESTION\_CSDR\_9>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_9>

1. In your view, where settlement instructions have been matched after the intended settlement date, and that intended settlement date is beyond the agreed number of business days in the past, the use of more recent reference data (last available data) for the calculation of the related cash penalties should be optional or compulsory? Please also state the reasons for your answer.

<ESMA\_QUESTION\_CSDR\_10>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_10>

1. Do you have other suggestions? If yes, please specify, provide drafting suggestions and provide arguments including data where available.

<ESMA\_QUESTION\_CSDR\_11>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_11>

1. Do you agree with the approach followed to incorporate proportionality in the Technical Advice? If not, please provide an indication of further proportionality considerations, detailed justifications and alternative wording as needed.

<ESMA\_QUESTION\_CSDR\_12>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_12>

1. What costs and benefits do you envisage related to the implementation of the approach proposed by ESMA? 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.

<ESMA\_QUESTION\_CSDR\_13>

|  |  |  |
| --- | --- | --- |
| **Approach proposed by ESMA** |  | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_13>

1. If applicable (if you have suggested a different approach than the one proposed by ESMA), please specify the costs and benefits you envisage related to the implementation of the respective approach. 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.

<ESMA\_QUESTION\_CSDR\_14>

|  |  |  |
| --- | --- | --- |
| **Approach proposed by respondent** (if applicable) |  | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_14>

1. Based on your experience, what has been the impact of CSDR cash penalties on reducing settlement fails (by type of asset as foreseen in the Annex to Commission Delegated Regulation (EU) 2017/389 since the application of the regime in February 2022? Please provide data and arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_15>

A slight decrease in penalties has been observed since the introduction of CSDR. However, the fundamental disciplinary impact is, in our view, not noticeable due to the low penalty rates so far.

Definitely, CSDR penalties significantly increased awareness of the importance of timely settlement and have clearly contributed to a reduction of the settlement fails. For example the annual settlement efficiency data published by Clearstream shows a significant increase in the “by volume” and “by value” settlement efficiency rates for 2023 compared to 2022.

No relevant changes could be observed on specific asset type levels. Especially ETFs instruments (and subsequently those participants significantly active in the ETF business) continuously show comparably low settlement efficiency levels due to the currently complex processes.

One of our members saw that the total number of penalties has decreased by about 35%. The proportion of Late Matching Fail Penalty (LMFP) has also decreased from approximately 13% initially to around 5% currently. This reduction in total penalties, especially the decline in Late Matching Fail Penalties, indicates a positive trend in overall penalty management.

<ESMA\_QUESTION\_CSDR\_15>

1. In your view, is the current CSDR penalty mechanism deterrent and proportionate? Does it effectively discourage settlement fails and incentivise their rapid resolution? Please provide data and arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_16>

The existing penalty structure, particularly for small transactions, in some cases lacks the deterrent effect needed to prompt corrective actions. Penalties in the cent range might be perceived as negligible, potentially diminishing their effectiveness in encouraging timely settlements. Analysis in some institutions shows that 80-90% of penalties are below €5. This may, for example, be due to the fact that the securities are located in another country. Hence, for the settlement the securities must first be transferred to Germany. If such transfer is more expensive than the penalties, there is no incentive to ensure a timely settlement.

Secondly, the observation about limited improvements in specific settlement areas, such as those involving a transfer agent, suggests that certain segments of the settlement process may require targeted enhancements. Identifying and addressing these specific areas is crucial for achieving comprehensive improvements in settlement efficiency.

To stronger incentivize partial settlements could also lead to an improvement in settlement efficiency. Under no circumstances should the structure of penalty fees become more complicated (such as the introduction of a minimum fee).

<ESMA\_QUESTION\_CSDR\_16>

1. What are the main reasons for settlement fails, going beyond the high level categories: “fail to deliver securities”, “fail to deliver cash” or “settlement instructions on hold”? Please provide examples and data, as well as arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_17>

The primary cause behind the "fail to deliver securities" category are penalties resulting from open counter-trades, necessary pre-allocations, or outstanding collaterals in repo transactions. Numerically, these account for the majority of penalties, although the individual penalty amounts are generally quite low.

One noticeable aspect regarding the penalty amounts pertains to Late Matching Fail Penalties, arising from matching issues. The process of resolving such mismatches often spans several days, resulting in relatively high penalty payments.

The main reason behind “settlement instructions on hold” is the German Depotgesetz (Custody Act), which excludes third-party disposals.

<ESMA\_QUESTION\_CSDR\_17>

1. What tools should be used in order to improve settlement efficiency? Please provide examples and data, as well as arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_18>

We, the Associations representing more than 1100 banking institutions in the German banking market, notice that developments in recent months have shown that settlement efficiency has improved. The extent to which this is due to the penalties or other aspects (interest rate increases) will never be clearly proven. It can also be assumed that the future restriction of CSDR for penalties to trading transactions (not operations that are not considered as trading) will improve the settlement efficiency ratio. We therefore believe that no comprehensive reorganisation of the penalty regime is required or necessary. The system should remain as simple as possible. A moderate and linear increase in the penalty rates applicable to settlement fails should be sufficient to achieve further improvements in settlement efficiency.

Any change to the existing system would be very costly for everyone involved. It is not clear why a completely new method should be better than a linear modification of the existing calculation. All market participants would then be forced to extensively rebuild their systems. Against the background of a cost-benefit analysis, this is questionable. We also believe that a system that is too complex would make the European location unattractive in competition with other jurisdictions.

Even though implementing a threshold for penalties (e.g. setting a minimum penalty of 5 € for each failed transaction) may seem like a simple encouragement for market participants to prioritize the resolution of all settlement fails, irrespective of their size, contributing to an overall improvement in settlement efficiency. However, this would also complicate the system and would not be, from our point of view, better than a moderate general increase.

The extended use of “hold & release” as well as partial settlement/ release functionalities and securities lending services could further enhance settlement efficiency.

In addition, processes preceding the sending of the settlement instructions should also be assessed by the relevant stakeholders to complete the picture and address issues that already occur much earlier, e.g. on trading level.

<ESMA\_QUESTION\_CSDR\_18>

1. What are your views on the appropriate level(s) of settlement efficiency at CSD/SSS level, as well as by asset type? Please provide data and arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_19>

We, the Associations representing more than 1100 banking institutions in the German banking market would like to point out that the original purpose of the introduction of the penalty regime was to increase market stability and reduce risk in the settlement system by seeing a sustainable improvement in settlement fails. We feel that this has been achieved by the market through the adoption of new technologies and increased automated processes by market participants, as well as increased focus on resolving the root causes of fails.

Ultimately, as recognized by ESMA in its consultation paper, achieving 100% settlement efficiency rates is not possible – not least because of because of the various infrastructures in the EU market. Creating an environment where failing is disproportionately economically punitive will only change the way in such securities are traded and priced, eroding liquidity further and creating additional costs for investors and, ultimately, issuers. Thus, at some point there is a trade-off between having a strict “no-fails market” driven by settlement discipline measures and having a deep, liquid, globally competitive market that is attractive to investors and issuers.

We do not recommend that ESMA propose a fix level of settlement efficiency but rather ensure that a sustainable reduction in settlement fails is maintained by the market, with evidence of improvement over a period of time. Again, the outcome of the current regime cannot be fully assessed within a short period of time, taking into account that several external factors since its implementation have impacted EU settlement efficiency rates.

<ESMA\_QUESTION\_CSDR\_19>

1. Do you think the penalty rates by asset type as foreseen in the Annex to Commission Delegated Regulation (EU) 2017/389 are proportionate? Please provide data and arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_20>

Yes, we believe that the current differentiation is appropriate. Here, too, any radical change to the system will result in high costs for all market participants and few recognisable benefits. The penalty regime should be kept simple and transparent and excessive complexity needs to be avoided.

In general we are concerned that the competitiveness of the EU capital markets could be negatively impacted by the application of overly high (or even extreme) penalty rates.

<ESMA\_QUESTION\_CSDR\_20>

1. Regarding the proportionality of the penalty rates by asset type as foreseen in the Annex to Commission Delegated Regulation (EU) 2017/389, ESMA does not have data on the breakdown of cash penalties (by number and value) applied by CSDs by asset type. Therefore, ESMA would like to use this CP to ask for data from all EEA CSDs on this breakdown, including on the duration of settlement fails by asset type.

<ESMA\_QUESTION\_CSDR\_21>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_21>

1. In your view, would progressive penalty rates that increase with the length of the settlement fail be justified? Please provide examples and data, as well as arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_22>

The majority of the penalties typically pertain to a short timeframe of 1-2 days. Penalties that increase with the duration of the settlement failure could serve as a motivational tool to remediate settlement fails and may encourage the counterparties involved in the transaction to exert the necessary efforts and expedite the resolution of the settlement issue, especially in cases where discussions become protracted or challenging.

However, progressive rates also complicate the penalty system. A streamlined and easily understandable penalty system is essential for effective communication, comprehension, and adherence by market participants. Uncomplicated rules facilitate transparency and help avoid potential misinterpretations or disputes, ensuring that the penalty mechanism serves its intended purpose without unnecessary intricacies. Any change would require significant IT developments (including testing) for any EU/ EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails). As the negative effects of progressive rates (calculations and allocations become also increasingly more complex) seem to outweigh the benefits, we do not think that such an approach would be justified.

<ESMA\_QUESTION\_CSDR\_22>

1. What are your views regarding the introduction of convexity in penalty rates as per the ESMA proposed Option 2 (settlement fails caused by a lack of liquid financial instruments)? Please justify your answer by providing quantitative examples and data if possible.

<ESMA\_QUESTION\_CSDR\_23>

We advocate for straightforward penalty rates. Our position is grounded in the belief that introducing unnecessary complexities to the rule framework does not yield significant benefits. A streamlined and easily understandable penalty system is essential for effective communication, comprehension, and adherence by market participants. Uncomplicated rules facilitate transparency and help avoid potential misinterpretations or disputes, ensuring that the penalty mechanism serves its intended purpose without unnecessary intricacies.

Focusing solely on liquidity when calculating penalties would represent a significant change compared to the current approach. The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/ EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails).

<ESMA\_QUESTION\_CSDR\_23>

1. Would it be appropriate to apply the convexity criterion to settlement fails due to a lack of illiquid financial instruments as well? Please justify your answer by providing quantitative examples and data if possible.

<ESMA\_QUESTION\_CSDR\_24>

Please refer to our answer under Q 23.

<ESMA\_QUESTION\_CSDR\_24>

1. What are your views regarding the level of progressive penalty rates:

**a) as proposed under Option 1?**

**b) as proposed under Option 2?**

<ESMA\_QUESTION\_CSDR\_25>

We, the Associations representing more than 1100 banking institutions in the German banking market, generally oppose increasing penalty rates. Implementing changes to penalty rate categories may necessitate adjustments to various technical aspects, such as interfaces and reporting presentations throughout the entire settlement process chain. We would like to question whether the efforts and costs involved in these technical adaptations would be justified in terms of the overall benefits gained. Therefore, our inclination is to prioritize a comprehensive evaluation of generally higher penalty rates before considering additional adjustments that may introduce complexities and raise questions about their cost-effectiveness.

Please see also our response to Question 22.

For the sake of clarity, we note that already today ETFs (category “ETFS”) are penalized in the same way as the categories “SECU”, “UCIT”, “EMAL” and “other” instruments (per fail day, 0.50/ 0.25 bp´s apply) and we see no obvious reason why a new category for ETFs should be added.

<ESMA\_QUESTION\_CSDR\_25>

1. If you disagree with ESMA’s proposal regarding the penalty rates, please specify which rates you believe would be more appropriate (i.e. deterrent and proportionate, with the potential to effectively discourage settlement fails, incentivise their rapid resolution and improve settlement efficiency). Please provide examples and data, as well as arguments to justify your answer. If relevant, please provide an indication of further proportionality considerations, detailed justifications and alternative proposals as needed.

<ESMA\_QUESTION\_CSDR\_26>

We, the Associations representing more than 1100 banking institutions in the German banking market, strongly favor to keep the current system with a slight / moderate general increase of the penalty rates. The current set-up is in place for only two years – with the first year being affected by the war in Ukraine – and has already shown positive effects.

Implementing changes to penalty rate categories may necessitate adjustments to various technical aspects, such as interfaces and reporting presentations throughout the entire settlement process chain. We would like to question whether the efforts and costs involved in these technical adaptations would be justified in terms of the overall benefits gained. Therefore, our inclination is to prioritize a comprehensive evaluation of generally higher penalty rates before considering additional adjustments that may introduce complexities and raise questions about their cost-effectiveness.

<ESMA\_QUESTION\_CSDR\_26>

1. What are your views regarding the categorisation of types of fails:

**a) as proposed under Option 1?**

**b) as proposed under Option 2?**

**Do you believe that less/further granularity is needed in terms of the types of fails (asset classes) subject to cash penalties? Please justify your answer by providing quantitative examples and data if possible.**

<ESMA\_QUESTION\_CSDR\_27>

The two suggested options would represent a significant change compared to the current penalty calculation approach. The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/ EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails). Please also refer to our answer to Q 26.

<ESMA\_QUESTION\_CSDR\_27>

1. What costs and benefits do you envisage related to the implementation of progressive penalty rates by asset type (according to ESMA’s proposed Options 1 and 2)? 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.

<ESMA\_QUESTION\_CSDR\_28>

|  |  |  |
| --- | --- | --- |
| **Progressive penalty rates (by asset type) - ESMA’s proposal Option 1** | **Please see ESMA’s proposed Option 1 in Section 5.3 of this CP.** | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Progressive penalty rates (by asset type) - ESMA’s proposal Option 2** | **Please see ESMA’s proposed Option 2 in Section 5.3 of this CP.** | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

We, the Associations representing more than 1100 banking institutions in the German banking market, oppose the introduction of progressive penalty rates. The implementation of any changes to the penalty mechanism is unnecessarily complex. Please also refer to our answer under Q 26 and 27.

The two suggested options would represent a significant change compared to the current penalty calculation approach. The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/ EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails).

<ESMA\_QUESTION\_CSDR\_28>

1. Alternatively, do you think that progressive cash penalties rates should take into account a different breakdown than the one included in ESMA’s proposal above for any or all of the following categories:

**(a) asset type;**

**(b) liquidity of the financial instrument;**

**(c) type of transaction;**

**(d) duration of the settlement fail.**

**If you have answered yes to the question above, what costs and benefits do you envisage related to the implementation of progressive penalty rates according to 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.**

<ESMA\_QUESTION\_CSDR\_29>

We oppose the introduction of progressive penalty rates. The implementation of any changes to the penalty mechanism is unnecessarily complex. Please also refer to our answer under Q 26 and 27.

The consideration of any new criteria would represent a significant change compared to the current approach. The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/ EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails).

As a side aspect: the transaction type is not a matching criteria for settlement transactions, hence, the information could deviate between the securities delivery and receipt leg of a transaction making the application of penalties based on this criteria “random” at best.

|  |  |  |
| --- | --- | --- |
| **Progressive penalty rates – respondent's proposal** *(if applicable)* |  | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_29>

1. Another potential approach to progressive penalty rates could be based not only on the length of the settlement fail but also on the value of the settlement fail. Settlement fails based on instructions with a lower value could be charged a higher penalty rate than those with a higher value, thus potentially creating an incentive for participants in settling smaller value instructions at their intended settlement date (ISD). Alternatively, settlement fails based on instructions with a higher value could be charged a higher penalty rate than those with a lower value. In your view, would such an approach be justified? Please provide arguments and examples in support of your answer, including data where available. What costs and benefits do you envisage related to the implementation of this approach? 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.

<ESMA\_QUESTION\_CSDR\_30>

We oppose the mechanism. Please see our feedback to Questions 27 to 29.

The consideration of any new criteria would represent a significant change compared to the current approach. The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/ EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails). Hence, we oppose the introduction of progressive penalty rates. The implementation of any changes to the penalty mechanism is unnecessarily complex.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Progressive penalty rates – based on the length and value of the settlement fail** | **Settlement fails based on lower value settlement instructions could be charged a higher penalty rate than those based on higher value settlement instructions** | | **Settlement fails based on higher value settlement instructions could be charged a higher penalty rate than those based on lower value settlement instructions** | |
|  | **Qualitative description** | **Quantitative description/ Data** | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_30>

1. Besides the criteria already listed, i.e. type of asset, liquidity of the financial instruments, duration and value of the settlement fail, what additional criteria should be considered when setting proportionate and effective cash penalty rates? Please provide examples and justify your answer.

<ESMA\_QUESTION\_CSDR\_31>

No additional criteria should be considered as any new criteria would represent a significant change compared to the current approach. The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/ EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails).

<ESMA\_QUESTION\_CSDR\_31>

1. Would you be in favour of the use of the market value of the financial instruments on the first day of the settlement fail as a basis for the calculation of penalties for the entire duration of the fail? ESMA would like to ask for the stakeholders’ views on the costs and benefits of such a measure. 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.

<ESMA\_QUESTION\_CSDR\_32>

TYPE YOUR TEXT HERE

|  |  |  |
| --- | --- | --- |
| **Use the market value of the financial instruments on the first day of the settlement fail as a basis for the calculation of penalties for the entire duration of the fail** |  | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

The simplicity and clarity of the penalty mechanisms are crucial factors for their effectiveness. Complex mechanisms not only pose challenges in terms of implementation and administration but can also be difficult to convey to customers when penalties are passed on to them.

Using straightforward and easily understandable penalty mechanisms ensures that market participants can grasp the rationale behind penalty assessments. This transparency not only facilitates compliance but also enhances the overall effectiveness of the penalty system by promoting a clear understanding of the consequences associated with settlement-related actions or inactions.

Choosing simpler mechanisms aligns with the goal of promoting transparency, accountability, and ease of comprehension for all stakeholders involved in the settlement process. It helps maintain a fair and accessible penalty framework that supports efficient settlement practices across the financial landscape.

<ESMA\_QUESTION\_CSDR\_32>

1. How should free of payment (FoP) instructions be valued for the purpose of the application of cash penalties? Please justify your answer and provide examples and data where available.

<ESMA\_QUESTION\_CSDR\_33>

We see no need for changes, the current process should continue to apply.

<ESMA\_QUESTION\_CSDR\_33>

1. Do you think there is a risk that higher penalty rates may lead to participants using less DvP and more FoP settlement instructions? Please justify your answer and provide examples and data where available.

<ESMA\_QUESTION\_CSDR\_34>

We are of the view that the replacement of DVPs by FOPs at a significant scale seems very unlikely.

<ESMA\_QUESTION\_CSDR\_34>

1. ESMA is considering the feasibility of identifying another asset class subject to lower penalty rates: “bonds for which there is not a liquid market in accordance with the methodology specified in Article 13(1), point (b) of Commission Delegated Regulation (EU) 2017/583 (RTS 2)”. The information on the assessment of bonds’ liquidity is published by ESMA on a quarterly basis and further updated on FITRS. However, ESMA is also aware that this may add to the operational burden for CSDs that would need to check the liquidity of bonds before applying cash penalties. As such, ESMA would like to ask for the stakeholders’ views on the costs and benefits of such a measure. 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.

<ESMA\_QUESTION\_CSDR\_35>

|  |  |  |
| --- | --- | --- |
| **Applying lower penalty rates for illiquid bonds** |  | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

Additional asset classes are not necessary. They overly complicate the penalty system and do not provide any discernible benefits. Even though the calculation of penalties is primarily the responsibility of the CSDs, the system should be easily understandable for market participants.

The inclusion of more asset classes could introduce unnecessary complexity into the penalty framework without clear advantages. It is essential to prioritize simplicity and transparency in the penalty calculation process to ensure that market participants can easily grasp the rules and implications. This not only facilitates a clearer understanding of the penalty mechanism but also empowers parties to scrutinize and contest any penalties that may have been inaccurately calculated.

Promoting a transparent and comprehensible penalty system not only aligns with the principles of fairness and accountability but also contributes to a smoother interaction between market participants and the regulatory framework. Clarity in penalty calculations supports a more efficient and responsive settlement environment by allowing for effective communication and resolution in cases where concerns or discrepancies arise.

<ESMA\_QUESTION\_CSDR\_35>

1. Do you have other suggestions for further flexibility with regards to penalties for settlement fails imposed on illiquid financial instruments? Please justify your answer and provide examples and data where available.

<ESMA\_QUESTION\_CSDR\_36>

The existing framework provides ample room for both parties to collaboratively adjust instructions, allowing for a more adaptive and responsive approach to settlement processes. It is within their discretion to cancel or modify instructions based on mutual agreement and, if needed, incorporate new parameters to facilitate smooth settlement. Encouraging a proactive utilization of this existing flexibility can contribute to a more dynamic and efficient settlement environment.

This flexibility can be particularly advantageous in situations where unexpected developments or changes in circumstances warrant adjustments to settlement instructions. By promoting increased utilization of this mechanism, market participants can enhance their ability to navigate evolving conditions, fostering a settlement process that is not only effective but also responsive to the dynamic nature of financial markets.

<ESMA\_QUESTION\_CSDR\_36>

1. How likely is it that underlying parties that end up with “net long” cash payments may not have incentives to manage their fails or bilaterally cancel failing instructions as they may “earn” cash from penalties? How could this risk be addressed? Please justify your answer and provide examples and data where available.

<ESMA\_QUESTION\_CSDR\_37>

There could be multiple cases where transactions are only unilaterally cancelled and remain subject to continuous penalties. T2S cancels even matched failing settlement transactions after 60 days so the issue is limited to 2 months from a T2S “efficiency” perspective. Applying the same approach by all (I)CSDs could mitigate the issue.

<ESMA\_QUESTION\_CSDR\_37>

1. How could the parameters for the calculation of cash penalties take into account the effect that low or negative interest rates could have on the incentives of counterparties and on settlement fails? Please provide examples and data, as well as arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_38>

Please refer to our answer to Question 1 – no changes should be made.

<ESMA\_QUESTION\_CSDR\_38>

1. To ensure a proportionate approach, do you think the penalty mechanism should be applied only at the level of those CSDs with higher settlement fail rates? Please provide examples and data, as well as arguments to justify your answer. If your answer is yes, please specify where the threshold should be set and if it should take into account the settlement efficiency at:

**a) CSD/SSS level (please specify the settlement efficiency target);**

**b) at asset type level (please specify the settlement efficiency target); or**

**c) other (please specify, including the settlement efficiency target).**

<ESMA\_QUESTION\_CSDR\_39>

No. The efficiency of settlement processes is subject to dynamic factors and can evolve independently of market conditions. Therefore, it is not appropriate to differentiate or categorize CSDs based solely on the volume of transactions they handle – since higher volume will result in higher fail rates. Such a classification may not accurately reflect the actual efficiency and operational capabilities of a CSD.

Every CSD should be assessed on its own merits, considering its specific processes, infrastructure, and overall performance in facilitating seamless and timely settlement. This approach ensures a fair and objective evaluation that aligns with the fundamental goal of enhancing settlement efficiency across the broader financial landscape. Treating CSDs uniformly, regardless of transaction volume, promotes consistency and fairness in regulatory and operational considerations.

In addition, applying the penalty mechanism only at the level of those CSDs with higher settlement fail rates would heavily damage (intra- and outside EU/ EEA) competition and level-playing field and target the wrong entities as CSDs are not the ones who could significantly steer the settlement efficiency of their participants.

<ESMA\_QUESTION\_CSDR\_39>

1. Please specify what costs and benefits you envisage regarding the application of the penalty mechanism only at the level of the CSDs with higher settlement fail rates. 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.

<ESMA\_QUESTION\_CSDR\_40>

|  |  |  |
| --- | --- | --- |
| **Application of the penalty mechanism only at the level of CSDs with lower settlement fail rates** |  | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

In addition to our response to Question 39, especially for T2S CSDs, such approach would be extremely counterproductive: for T2S and its participants, the running and development cost of the penalty mechanism would be attributed to a much smaller customer base, hence, heavily increase the cost distributed to few CSDs and clients what will make the use of such CSDs or even T2S unreasonable.

For T2S, significant impact/cost can be expected.

<ESMA\_QUESTION\_CSDR\_40>

1. Do you think penalty rates should vary according to the transaction type? If yes, please specify the transaction types and include proposals regarding the related penalty rates. Please justify your answer and provide examples and data where available. 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.

<ESMA\_QUESTION\_CSDR\_41>

Applying uniform penalty rates, regardless of the trade type, ensures a straightforward and transparent approach to enforcing penalties. It eliminates the potential for manipulation by discouraging participants from choosing specific transaction types solely based on their penalty implications. This simplification of the penalty mechanism promotes fairness and equity, fostering a level playing field for all market participants. In addition, the transaction type is not a matching criteria for settlement transactions, hence, the information could deviate between the securities delivery and receipt leg of a transaction making the application of penalties based on this criteria “random” at best.

Furthermore, a consistent penalty framework serves to maintain the integrity of the settlement system, as it discourages attempts to game the penalty structure. This approach aligns with the overarching goal of creating a robust and reliable settlement environment that operates on principles of fairness, accountability, and efficiency.

The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/ EEA CSDs, T2S and participants and would make the application of penalty rates much more complex.

|  |  |  |
| --- | --- | --- |
| **Applying penalty rates by transaction types** |  | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_41>

1. Do you think that penalty rates should depend on stock borrowing fees? If yes, do you believe that the data provided by data vendors is of sufficient good quality that it can be relied upon? Please provide the average borrowing fees for the 8 categories of asset class depicted in Option 1. (i.e. liquid shares, illiquid shares, SME shares, ETFs, sovereign bonds, SME bonds, other corporate bonds, other financial instruments).

<ESMA\_QUESTION\_CSDR\_42>

No.

<ESMA\_QUESTION\_CSDR\_42>

1. Do you have other suggestions to simplify the cash penalty mechanism, while ensuring it is deterrent and proportionate, and effectively discourages settlement fails, incentivises their rapid resolution and improves settlement efficiency? Please justify your answer and provide examples and data where available. 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.

<ESMA\_QUESTION\_CSDR\_43>

TYPE YOUR TEXT HERE

|  |  |  |
| --- | --- | --- |
| **Respondent’s proposal** (if applicable) |  | |
|  | **Qualitative description** | **Quantitative description/ Data** |
| **Benefits** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Compliance costs:**  **- One-off**  **- On-going** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Costs to other stakeholders** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |
| **Indirect costs** | TYPE YOUR TEXT HERE | TYPE YOUR TEXT HERE |

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_43>

1. Based on your experience, are settlement fails lower in other markets (i.e USA, UK)? If so, which are in your opinion the main reasons for that? Please also specify the scope and methodology used for measuring settlement efficiency in the respective third-country jurisdictions.

<ESMA\_QUESTION\_CSDR\_44>

The European market's fragmentation, characterized by the presence of multiple CSDs, introduces a level of complexity that can potentially lead to delays in the settlement process. In contrast, the United States benefits from a more centralized structure with the Federal Reserve (FED) and the Depository Trust and Clearing Corporation (DTCC) serving as the primary CSDs. This centralized setup contributes to a more streamlined and efficient settlement process, reducing the likelihood of delays. Therefore, the European market is not comparable with other markets, e.g. the US market.

The inherent challenge in a fragmented market lies in coordinating and reconciling transactions across various CSDs, each with its own set of rules and procedures. This can result in additional layers of complexity and potential bottlenecks in the settlement chain. Acknowledging this difference between the European and U.S. markets underscores the importance of addressing these challenges and promoting initiatives that enhance the efficiency and harmonization of settlement processes across the European landscape.

<ESMA\_QUESTION\_CSDR\_44>

1. Do CSD participants pass on the penalties to their clients? Please provide information about the current market practices as well as data, examples and reasons, if any, which may impede the passing on of penalties to clients.

<ESMA\_QUESTION\_CSDR\_45>

Most of our members pass on penalties to their clients to the extend the clients are considered to be legally impacted (i.e. excluding retail clients).

<ESMA\_QUESTION\_CSDR\_45>

1. Do you consider that introducing a minimum penalty across all types of fails would improve settlement efficiency? Is yes, what would be the amount of this minimum penalty and how should it apply? Please provide examples and data, as well as arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_46>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_46>

1. What would be the time needed for CSDs and market participants to implement changes to the penalty mechanism (depending on the extent of the changes)? Please provide arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_47>

The process of penalty calculation is within the purview of the CSDs or Target2-Securities (T2S). Consequently, the primary responsibility for addressing this question lies with these entities, e.g. Central Banks.

It is imperative to afford market participants an adequate lead time for timely communication to clients. This allows for effective planning and communication strategies, ensuring that market participants can convey relevant information to their clients in a timely manner. Providing a sufficient lead time facilitates a smoother and more transparent communication process between market participants and their clients in response to penalty-related matters.

<ESMA\_QUESTION\_CSDR\_47>

1. Since the application of the RTS on Settlement Discipline, how many participants have been detected as failing consistently and systematically within the meaning of Article 7(9) of CSDR? How many of them, if any, have been suspended pursuant to same Article?

<ESMA\_QUESTION\_CSDR\_48>

Our members could not identify any particular counterparty as consistently failing to meet its obligations. The penalties incurred apply broadly across different counterparties, and no suspension of any specific counterparty has been implemented to date.

<ESMA\_QUESTION\_CSDR\_48>

1. In your view, would special penalties (either additional penalties or more severe penalty rates) applied to participants with high settlement fail rates be justified? Should such participants be identified using the same thresholds as in Article 39 of the RTS on Settlement Discipline, but within a shorter timeframe (e.g. 2 months instead of 12 months)? If not, what criteria/methodology should be used for defining participants with high settlement fail rates? Please provide examples and data, as well as arguments to justify your answer.

<ESMA\_QUESTION\_CSDR\_49>

The calculation and logic of penalties should be simplified rather than made more complex. Ultimately, all open transactions contribute equally to Settlement Efficiency, regardless of the nature, type, or security of the underlying transaction. In this context, less complexity leads to greater efficacy.

Participants should not be treated differently as the actual settlement efficiency is dependent on many factors (like structural/ legal aspects, business models, underlying client bases, financial instruments served, location/ region/ time-zone) that cannot always, easily or at all be influenced by the CSD and/ or its participants, as illustrated in our feedback to e.g. Questions 6, 16 and 17. Hence, an “automatic” increase of penalties for certain participants must be absolutely avoided.

It is also unclear who would benefit from such fees and how they should be processed/ paid when ESMA states “These special penalties would be in addition to the general cash penalty mechanism provided for in CSDR. In principle, they would not be credited to the participant’s counterparties and should not represent an additional source of income for the CSD.”.

Leaving aside any IT development cost (including for T2S) we believe the existing “suspension” process (see as well Question 48) perfectly serves the purpose to incentivise relevant participants to take mitigating actions, whenever possible.

<ESMA\_QUESTION\_CSDR\_49>

1. How have CSDs implemented working arrangements with participants in accordance with article 13(2) of the RTS on Settlement Discipline? How many participants have been targeted?

<ESMA\_QUESTION\_CSDR\_50>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_50>

1. Should the topic of settlement efficiency be discussed at the CSDs’ User Committees to better identify any market circumstances and particular context of participant(s) explaining an increase or decrease of the fail rates? Please justify your answer.

<ESMA\_QUESTION\_CSDR\_51>

In the Clearstream User Committee (CUC), there is an ongoing and regular discourse on this particular topic. A similar approach could be adopted by all CSDs to sustain heightened awareness across various markets.

<ESMA\_QUESTION\_CSDR\_51>