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 | Xchange Now e.V. |
| Activity | Retail investors |
| Are you representing an association? |[x]
| Country / Region | Europe |

# 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>

No comment at this time

<ESMA\_QUESTION\_CSDR\_1>

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

<ESMA\_QUESTION\_CSDR\_2>

No comment at this time

<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>

No comment at this time

<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** |  Household (retail investors) are harmed when they do not receive the securities they pay for. Contractual Settlement Date Accounting, a standard used throughout the financial industry, means brokers/banks take cash from investors accounts on settlement date WHETHER OR NOT they have the  | Data for the cost to household investors are included in “Settlement Fails in US Bond Markets”, estimated as $7 billion annually in the US alone. Working paper available at [https://ssrn.com/abstract=1016873](https://ssrn.com/abstract%3D1016873) |
| **Indirect costs** |  Indirect costs include loss of use of funds, and difference between trade-date and settlement-date price. |  Cannot be quantified with available data as most CSD’s that release FTD data report only current market price values. |

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>

N/A

<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>

N/A

<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>

No comment at this time.

<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>

No comment at this time.

<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>

No comment at this time.

<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>

No comment at this time.

<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>

No comment at this time.

<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>

No comment at this time.

<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 |

No comment at this time.

<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 |

No comment at this time.

<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>

According to the publicly accessible data provided by CSDs and ECB, settlement fails in EU in 2023 remain far too high despite introduction of penalties.

<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>

No, the current penalty mechanism is not sufficient, otherwise settlement efficiency in EU would be much higher. The easiest and least bureaucratic way to sustainably reduce settlement fails would be standardized, transparent, automated buy-in procedures. This procedure would be predictable, calculable and comprehensible for all market players. In order to sustainably reduce failure-to-deliver, there must be no economic benefit for the failing participant. In short, "failing" must not be profitable. This will be the case if the failing participant expects that an up-tick bidding procedure through the CSD will take place on an exchange trading venue at the failing party’s expense. This process has been used successfully in Singapore, for example.

<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 overwhelming proportion of settlement fails in the EU is due to non-delivery of the securities sold. Defaults due to non-payment of money represent a very small proportion of settlement fails in the EU. The main reason for settlement fails are a lack of stock lending, uncovered short selling and uncontrolled market making activities. Market makers enjoy exceptional rights in the EU, such as creating shares out of thin air, despite the lack of a clear definition of the term “market maker” or any registration requirements. The Market Maker Regulation merely stipulates that market making activities must be notified to the National Competent Authority (NCA) 30 days before they commence. There appears to be no transparent supervision regarding market making activities. This means that there is no data available in the EU on the extent to which market makers make use of their special status of being able to create shares out of thin air. The EU Short Selling Regulation allows market makers to engage in "naked short selling". The EU Short Selling Regulation also permits naked short selling for shares that do not have their main trading venue in the EU. The largest and most active market makers worldwide often provide other - sometimes clearly competing - financial services in addition to their market making activities, which can lead to serious conflicts of interest from the perspective of household investors. Here too, standardized and automated buy-ins offer the simplest and safest way to prevent abusive market-making activities.

<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>

Standardized automated Buy-In procedures. Even large Central Securities Depositories such as Clearstream Banking emphasise the importance of Mandatory Buy-Ins in order to get a grip on the high rates of settlement fails. Tight settlement discipline and Buy-Ins are key elements in preventing failures to deliver with a significant impact on investor confidence and the stability of the capital markets: "In particular, the mandatory nature of the buy-in requirements is a key aspect of the rules to ensure a consistent up-take of such back-office procedures and avoid penalising market participants who do so on a voluntary basis." Another problem that needs to be addressed is the increasing internalisation of transactions by market players. Furthermore, there is no central database for sanction reference data (https://www.deutsche-boerse.com/resource/blob/3110226/8fea8d70b046a6bcc7a191a5d5d9a72f/data/may2022\_have-your-say-process.pdf).

<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>

While it may seem reasonable to assume that settlement efficiency can differ by asset type, the underlying assumption that it is acceptable to sell an asset that is not (and perhaps cannot be) delivered belies the absurdity of the question. It is preferable to consider different levels of efficiency depending on the age of the settlement failure (addressed later in this response).

We are not aware of any scientific study on the extent to which settlement fails are economically "harmless".

Settlement fails are not just a cosmetic problem:

* Failure to deliver cause damage to investors. The return on the money invested and paid is lost on the buy side, while the broker receives the money immediately and can use it to do business (e.g. overnight repo transactions).
* In the event of bankruptcy of the company between the purchase of the shares and actual settlement, only the owners of genuine shares have claims (we know from our own experience that some settlement fails persist for years). Household investors in particular may not be able to prove that they own real shares and not just phantom shares.
* Phantom shares massively undermine the shareholder’s AND company’s rights (overvoting) and destroy the integrity of co-determination.
* Phantom share disrupt price discovery on the market, as they simulate a higher supply of securities than were actually issued by the company or the state.
* In the UK, household investors are 8x more affected by FTDs than institutional investors (based on evidence analyzed by James Economides. Source: "Comparing Settlement Data", Richard Greensted, *Global Investor* (London), March 2006, P1).
* Settlement fails increase the systemic risk, e.g. in the event of an intermediary default: the NSCC's clearing fund contained USD 12.5 billion in 2021. This contrasted with open - i.e. unsettled - transactions totalling USD 249 billion!
* The loss of these investor rights in the case of company shares include voting rights and participation in special capital measures of the company that lead to skepticism regarding the integrity and transparency of the capital markets. For example, in the USA there are different tax treatments for "payments in lieu of dividends" as compared to more favourable tax treatment of actual dividends.

Against this background, the aim must be to keep settlement fails as low as possible. In purely empirical terms, the rate of settlement failures should be below 1% from the perspective of household investors. Even if ESMA regards FTDs of 0% as unrealistic it should be the goal of all efforts to keep this rate at low as possible. An FTD rate below 1% would be acceptable, but only if there is a publication obligation for all FTDs above 1%. Then, as a household investor, I can decide whether I want to buy the security anyway or not.

<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>

No comment at this time.

<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>

ESMA asks for data from CSDs on the number and value of penalties imposed including data on the duration of settlement fails and separately by asset type. We already addressed this issue in a letter to the EU authorities. We very much welcome this data. It would be extremely important for ESMA to report on this! That would be an important step towards market transparency and restoring trust in capital markets and financial intermediaries.

<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>

We agree with ESMA that a one-day fail is different from a 20-day fail. Therefore, the incentive must be aligned with closing FTDs as soon as possible. ESMA’s own data showed that the initial round of penalties did not decrease the quantity of fails (as a percent of trade value or volume) to a significant degree. Progressively higher penalty rates could provide the incentive to close out open positions. All economic incentives to fail a transaction must be removed, therefore penalties should increase with the duration of the settlement fail.

<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>

No comment at this time.

<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>

No comment at this time.

<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>

Option 1 is preferable and seems as if it would be easier to implement.

<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>

N/A

<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>

As stated earlier, we do not believe that more/less granularity is the answer to improving settlement efficiency. Simply stated, cash penalties, margin calls, and the threat of suspension (or even criminal prosecution as is currently the case in South Korea) plus mandatory buy-ins are all urgently needed across all asset classes. If ESMA allows, for example, more fails in ETFs than in underlying securities, it will be providing a loophole for failing participants to slip through. We saw this in the US with the (prohibited) use of swaps and derivatives to give the appearance of clearing a fail without delivering securities.

<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 |

No comment at this time.

<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>

Same answer as above.

|  |  |
| --- | --- |
| **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 |

Same answer as above.

<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>

If you disconnect the value of the fail from the trade-date price (like DTCC does in the US), the original investor is penalized if the price falls (which is the inherent impact of a settlement fail and the ultimate goal of naked short sales). The penalty falls with the price, which incentivizes the short seller/failing-party. We think keeping track of trade-date price is very important; closing the trade in a rising market (price rise for shares) is the penalty for settlement failure.

|  |  |  |
| --- | --- | --- |
| **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 |

N/A

<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 comment at this time.

<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>

Yes, as stated above, the trade-date price is the value that is removed from the investors’ cash accounts. Therefore, that is the price that should remain with the trade. However, an important question that is not addressed in this paper is the release of information to the investor – especially the household investor – that a trade has failed to settle. With that information, the investor could make better decision about which brokers/banks they want to give their business.

|  |  |
| --- | --- |
| **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 |

N/A

<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>

No comment at this time.

<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>

No comment at this time.

<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 |

I think it is a fool’s errand, as stated above, to open loopholes by making one or another asset class subject to looser penalties.

<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>

As stated above, there needs to be less flexibility, not more. From the sparse data ESMA has released to the public since CSDR implementation, stricter penalties are required to get the settlement efficiency under control.

<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>

For the situation described in paragraph 64 to be true, the brokers would have to collude. One broker would agree to keep paying the fail penalty so the other gets to keep the money. This is tantamount to money laundering – moving funds without moving assets.

<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>

It should be possible to set a minimum cash value for penalties.

<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>

One settlement efficiency target should apply market-wide. While we agree that a zero-fail target may be difficult to achieve, the addition suggested in this paper of account suspension (or criminal prosecution as used in other jurisdictions) would go a long way toward achieving that goal.

No, penalties should be applied to all CSDs

<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** |  Investors will put more trust in EU markets knowing that they will receive securities that they pay for. | ESMA has not released sufficient data on settlement fails to make an accurate calculation. However, with €10 billion turning over eery day just at Euronext (all markets), even a 1% fail rate means that household investors could have paid for millions of Euros worth of shares that they do not receive.  |
| **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 |

See above.

<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>

No. As stated above, the fail penalties need to be stricter, not more flexible. The money for settlement failures comes out of the pockets of household investors, taxpayers and voters plus the institutional funds and pension funds they rely on for security..

|  |  |
| --- | --- |
| **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 |

N/A

<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>

Borrowing securities does not close a settlement failure: it merely creates a new IOU. In fact, it creates a more permanent IOU than the failure to receive that the failure to deliver creates because stock loans do not have “due dates” when real shares must be returned. All shareholder rights go with the lent share and Household Investor (retail) account agreements state that the investor does not have to be told when their shares are lent and does not get to share in the profits made by lending this. This is a fact that ESMA appears not to recognize.

<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>

No comment at this time.

|  |  |
| --- | --- |
| **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>

Settlement fails in the USA and several Asian countries are lower than in the EU. Asian trading centers that have mandatory or automated buy-ins, such as Singapore, Hong Kong, Japan and Korea, have very low settlement fail rates. South Korea is pushing enforcement even against international firms. ESMA has all the settlement rules on its own website. There are some, like Taiwan, that do not allow settlement fails at all; instead, they “bust the trade”, meaning they do not process it for settlement if securities are not delivered on time. The increasing use of a Unique Transaction Identifier is making this option increasing possible in other jurisdictions.

For further information how mandatory buy-ins work it could be helpful to look at the Singapore Exchange. They provide daily reports about buy-ins: https://links.sgx.com/1.0.0/corporate-announcements/IPVGGEYRY5369S6Z/434f196c35870e3b5d7a1d0cc624d4ebedbab5f6dc452566421774a0a6a4b79a

<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>

No comment at this time.

<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>

Yes, a minimum penalty would resolve the question, as stated above, of imposing “negative penalty” rates. The minimum penalty could be set at, say €100 regardless of the value of the fail so that small value trades don’t fall through the cracks.

<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>

N/A

<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>

N/A

<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>

Yes, we welcome any actions that can provide the economic incentive for participants to not enter into trades they are not certain they can settle.

<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>

N/A

<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>

No, enough talk! CSDs and their user committees have been talking about settlement failures since 1969. It is time to get this fixed!

To summarise, we must emphasise that, from the perspective of Household Investors, settlement fails represent a very high investment risk. As ESMA itself points out, settlement fails in the EU are higher for equities than for bonds. And although equities are liquid assets, European CSDs report a lack of securities as the main reason why transactions fail. Lack of securities lending and short selling are primarily responsible for this.

In our view, the measures presented here, such as fines and suspensions, are very important but will not be enough. In addition, many variables need to be considered to achieve an effective and appropriate penalty mechanism for settlement fails. In our opinion, much of this would be unnecessary if the EU Parliament had adopted mandatory buy-ins as an early measure and not as a measure of last resort. **It is also not clear to us why mandatory buy-ins (MBIs) are considered so dangerous when they are used successfully in many other financial centres, especially in Asia. We are convinced that MBIs are the simplest, most transparent, effective, and reliable instrument for raising settlement efficiency**.

The forthcoming shortening of the settlement cycle to T+1 will create enormous additional pressure and if the EU does not very quickly and decisively do everything in its power to raise settlement efficiency to over 99%, even the fines will be of little help.

**It is not Mandatory Buy-Ins that pose a risk to the stability of capital markets, but the trading practices that lead to settlement fails.**

Above all, one thing must not be overlooked: the EU is not only striving for a capital markets union, but is also making a genuine effort to encourage Household Investors to invest in social security systems such as the planned establishment of equity-based pension funds in Germany with billions of taxpayers' money to flow into the capital markets over the next few years, a market that delivers what is owed step by step is indispensable.

<ESMA\_QUESTION\_CSDR\_51>