**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.

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**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 | Grupo BME |
| Activity | Credit institutions, CSDs, investment firms, market operators, e-money institutions, UCITS management companies, AIFs  |
| Are you representing an association? |[ ]
| Country / Region | Spain |

**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>

**Introductory remark**

**Iberclear community fully supports the objectives of the Settlement Discipline Regime (SDR) set forth by CSDR and the improvement of settlement efficiency and over time have significantly contributed to its implementation, participating in the ECSDA discussion paper on settlement efficiency in November 2023 (“Discussion Paper”), sharing the analysis undertaken by the ECSDA Settlement Working Group as well as some initial recommendations to improve settlement efficiency in Europe. The investigation and deep understanding of the root causes of settlement fails is indeed essential to assess the effectiveness of the current penalties' mechanism and any proposal for change or improvement.**

**We deem it important to highlight that settlement efficiency has been improving since the implementation of the regime, which took place only two years ago (February 2022), although it is not clear enough the effect on it of penalties implementation.**

**While the level of settlement efficiency has certainly been influenced also by interest rates, Iberclear consider that in any case two years do not represent a sufficiently long timeframe to achieve the objectives of the SDR and assess the outcome of its implementation; moreover, as already highlighted in the Discussion Paper, it is relevant to stress that as known, during such timeframe, mainly the first year, the market volatility has increased due to specific events, such as the war in Ukraine, the subsequent implementations of the EU and international, sanctions negatively affecting settlement efficiency to some extent.**

**It is to be highlighted that some of the proposals considered by ESMA in this consultation would bring significant structural changes to the way that SDR is applied currently; the successful implementation and adoption by the entire market, not only by the CSDs (including service providers), would require substantial development, testing and coordination efforts. This would represent a significant workload on top of the current efforts connected to the implementation of regulations and market standards that are in the pipeline generating project management concerns for the CSDs and for the market in general.**

**In addition, given the timeframe envisaged for the implementation of the proposals, as well as the latest developments on the shortening of the settlement cycle, so far it seems that the new regime could enter into force closely to the adoption of T+1 when probably a smoother regime would be advisable or even necessary. So, to rationalize resources, changes to cash penalties does not seem a priority and do not appear to be consistent with the forthcoming scenario.**

**The T+1 scenario is indeed mostly unknown, also in terms of potential increase of the settlement fails; statistics are being published in the market, showing an expected substantial increase of settlement fails as consequence of the transition to T+1 in US and Canada.**

**Changing the penalties mechanism and/or increasing the level of penalties in this uncertain scenario might therefore impact and prejudice the competitiveness of the EU capital markets.**

**Important to also add is that some change proposals would affect only a low percentage of transactions of the total of cases so would have minor effects on the settlement efficiency, if any at all.**

**Therefore, Iberclear kindly invite ESMA to take into consideration the comments included in this response and additionally to carefully assess the benefit-to-cost ratio of each proposal, including the proportionality, also mentioned by ESMA in the CP, as a critical guideline of this assessment.**

**Iberclear also consider it critical to incorporate in this assessment the need to have sufficient lead time for implementation of any change of the penalties mechanism. As example, allow us to mention that by experience, and according to the T2S governance, a T2S change request, depending on the complexity, once the requirements are fully documented in T2S could take 2-3 years for implementation and additional time may be also necessary for CSD and their communities (testing, client readiness, etc) to adapt to these changes.**

**Answer to Q1**

**Iberclear consider that all options (some more than others) seem to be quite complex, which may lead to longer duration of calculation processes or even errors, and also increase the risk of imbalances for CCPs (as it would be the case for progressive penalty rates by length and value).**

**Additionally, only a limited percentage of settlement fails are recycled and carried over to the next business day, so an insignificant number of transactions remains unsettled on and after the 4th business day.**

**For the mentioned reasons we do not see a benefit that would support the need for such proposed changes.**

**In any case, actual cash interest rates to be applied by CSDs for their daily penalty calculations should be already calculated by the Central Banks or ESMA and centrally published and maintained up to date by e.g., ESMA for all stakeholders. This ensures 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.**

<ESMA\_QUESTION\_CSDR\_1>

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

<ESMA\_QUESTION\_CSDR\_2>

**Please refer to the answer to Q1.**

<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 refer to the answer to Q1**

<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>

**Please refer to the answer to Q1**

<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>

**Yes, in the context of T2S governance, our service provider, the Eurosystem (T2S penalty mechanism) have identified that such issue exists on the level of the T2S penalty mechanism.**

<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>

**As stated in the mentioned ECSDA paper “Settlement efficiency considerations” (page 8) CSD participants have reported to their CSDs that there are several reasons for late matching although there are some of them more frequent such as:**

* **The need for correction of an instruction that is necessary to match the counterparty instruction or wrong SSIs sent by their underlying client.**
* **Missing information from the client to submit the instruction,**
* **Missing information from the counterparty.**
* **Dependencies on the internal processes, including ensuring the availability of securities, credit controls and approvals or other checks.**
* **Finally, in some cases, operational errors were also reported to be behind the late matching fails.**

**On top of that, they highlighted that in some cases further use of partial release/ settlement services could help to avoid re-instructing a previous settlement instruction and hence avoid late matching.**

**Also, in line with our participants, we recommend excluding market claims and transformations from the scope of penalties application as well as settlement fails reporting in future as:**

* **market claims/ transformations settlement transactions do not represent trading activity in any case.**
* **participants cannot directly influence the instructions generation.**
* **the application of penalties on market claims/ transformations leads to applying the penalty to a single failing transaction twice.**
* **Note that if a potential move to T+1 settlement resulted in a material increase in the level of settlement fails – i.e., increases the number of unsettled transactions over record date – the consequence of this may also be an increase in the number of market claims and subsequently late matching penalties.**

<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>

**Yes.**

<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>

**We consider supporting the proposal of 40 days, as it is already applied in T2S, as it helps T2S to not have performance issues.**

<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>

**Yes, although, Iberclear, as many other CSDs, support the recommendation for ESMA to centrally provide and publish all reference data needed to calculate penalties in a single database accessible to all stakeholders.**

<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>

**Iberclear consider (see reasons included in the “Introductory remark” in Q1 Response) that a change in the methodology, when there is not a clear benefit, would represent efforts and costs that would have to be assumed by all market actors with no proportionate return rate.**

<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.**

<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>

**We agree to optionally allow to limit the age of reference date used by CSDs or platforms to calculate penalties.**

**However, we believe proportionality would be best achieved by ESMA to centrally provide and publish all reference data needed to calculate penalties in a single database being accessible to all stakeholders.**

<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>

**In this respect, the T2S operator has raised a Change Request (CR-0802) to investigate the implementation efforts and costs of extending the threshold for calculation of LMFP from 40 to 92 days. As per the change request detailed assessment, its implementation would imply 925k€ of development costs and around 200k€ of yearly running & maintenance costs. These costs would only allow T2S to perform LMFP calculation with the correct (older) reference price for an additional 0,02% of the penalties in T2S platform, as per July-October 2023 data. On top of T2S operator costs, development, testing, and running costs for CSDs and their participants should also be considered.**

**As such, the benefit-cost ratio of implementing the change request is deemed** **very low and the change request has been put on hold in the T2S governance, awaiting further regulatory clarifications. The T2S operator suggests keeping a flexible approach in line with current processes, maintaining balance between costs and benefits.**

**Hence, the current T2S “40 days threshold” shall be maintained.**

<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>

**Not applicable**

<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>

**Iberclear, as other ECSDA CSDs, are of the opinion that CSDR penalties as well as complementary measures (like the working arrangements with relevant clients) significantly increased awareness of the importance of timely settlement to improve the efficiency of the market and reduce systemic risk, and have, at some extent, contributed to a reduction of the settlement fails. However as stated in Question 6 and 16 the scope of the SDR is currently too wide and is capable of being revisited with the aim of achieving proportionality of the measures to address settlement fails.**

<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>

**Based on feedback from participants, we believe that the SDR scope is currently too wide as it goes beyond the settlement of trading activity and covers participants as well´ “internal” and other specific transaction such as:**

* **Transfers between the same participant accounts.**
* **Market claims/ transformations (see our answer as well to Question 6).**
* **Primary market transactions.**
* **Portfolio transfers between the same and/ or different accounts/ participants.**

**In line with the participants, we therefore recommend adjusting the scope of transactions subject to penalties and settlement fails reporting for ESMA to focus actions on data that is truly relevant regarding settlement and financial risk aspects and remove the activities listed above from consideration in future.**

<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>

**As stated in the mentioned ECSDA paper “Settlement efficiency considerations” (pages 6-9), on top of the impact of markets volatility, the issues affecting settlement efficiency occur at** **different levels of the transaction processing chain.**

**From a mere CSD perspective, reasons of settlement fails (on top of those reasons included in the question) can be grouped in the mentioned categories, but the actual reasons are behind, among others, are:**

* **Need to increase the automation down the chain.**
* **Issues on reference data management.**
* **Issues on inventory management.**
* **Not full usage of CSDs functionalities.**

<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>

**As stated in the mentioned ECSDA paper “Settlement efficiency considerations” (pages 10-11) tools that can improve settlement efficiency are on different areas on the post-trading, not only restricted to CSD aspects. As far as CSDs are concerned, and irrespective of the root causes of settlement fails, to improve as much as possible settlement efficiency, Iberclear, as other ECSDA CSDs, encourage the simultaneous use of all existing tools offered by the CSDs,**

**As we have also mentioned during the last “shortening settlement cycle workshop” in Paris, last December the following elements shall be considered:**

* **Automation (speed and accuracy): harmonization and standardization.**
* **Settlement instructions tracking (faster reactions): improvement information flows.**
* **Inventory management improvement (resources coverage): facilitating x-border settlement when needed.**
* **Simultaneous and intensive use of CSD functionalities (efficiency): H&R, partial release/shaping, partial settlement...**
* **Reporting (avoid corrections, delays): continuous detailed information exchange.**

<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>

**Iberclear recognize that instructions settlement happen on intended settlement date is fundamental for the efficient functioning of capital markets but, having clarified that 100% is not an achievable target, we understand that the optimal level of settlement efficiency is tightly connected to:**

1. **The conviction that settlement system outside EU perform better,**
2. **the risk brought by failing transactions perceived by the market stakeholders, i.e., their risk appetite.**

**As per point 1), we also state in Question 44 that comparison amongst different SSS is not only impossible but, even worse, also misleading since 1) the algorithm used, 2) the accuracy of calculation and 3) the instructions to be considered, are often significantly different.**

**With reference to point 2), we understand that market operators (which are the one who bear this risk) are quite conscious of such risk and, as far as we know, the current level of settlement efficiency is not considered critical, also because it is in their interest to deliver/receive securities on time.**

**On the other hand, we understand the Regulators has an even lower risk appetite.**

**Consequently, we think that the level of optimal settlement efficiency is not objective but subjective and linked to the risk perception.**

**In this view, an indication from the market regulator seems necessary.**

**We also would like to say that, considering the forthcoming adoption of T+1, the EU market will have to complete activities, currently carried out in roughly 26 hours, in only 2 hours.**

**This will imply a strong effort of the market and will be the driver for improving settlement efficiency.**

<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>

**Please refer to “Introductory remark” in Q1 Response.**

<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>

**Please refer to “Introductory remark” in Q1 Response.**

<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>

**Considering our answers to Questions 16 and 17, given the variety of (structural and operational) reasons for settlement fails, we believe that the root causes for fails are not yet fully understood and actioned upon. Hence, no changes should be made at this stage as we have reasonable doubts that a (largely extremely significant) increase of the penalty rates would actually lead to more timely settlements overall. Instead, the root cause assessments of the stakeholders on “actionably avoidable” items should be continued and documented.**

**Also, such 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).**

**In addition, progressive penalty rates based on the length of the settlement fail could result in penalty imbalances for CCPs since the CCP can have purchase and sale instructions with different lengths pending to be settled (e.g., an older delivery trade could remain unsettled with a newer receiving trade which would mean that the CCP would be paid a higher penalty than the one that the CCP needs to pay).**

<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>

**Please refer to “Introductory remark” in Q1 Response.**

<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 “Introductory remark” in Q1 Response.**

<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>

**Please refer to “Introductory remark” in Q1 Response.**

<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>

**While Iberclear remain neutral on the level of the penalty rates, we caution that the introduction of new calculation criteria like the length or value of a settlement fail or solely the security liquidity would require relevant IT developments (including testing) for any EU/EEA CSDs, T2S and participants and would make the calculation of penalties by all relevant stakeholders much more complex for transactions failing for more than one day (including late matching fails). We also doubt there is a reasonable cost/ benefit ratio for such developments.**

**In any case, we are highly 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\_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>

**Please refer to “Introductory remark” in Q1 Response.**

<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>

**As preliminary assessment we consider:**

* **Option 1 would entail a medium to high implementation costs since it would impact the penalty mechanism computation logic (progressive rates) and add ETFs as new asset category (a small to medium impact since it could rely on existing methodology with CFI code).**
* **Option 2 would entail** **a very high impact on the penalty mechanism since it would impact the penalty mechanism computation logic (progressive rates with convexity) as well as constitute a structural change to the methodology for the derivation of asset classes.**

**Please refer to “Introductory remark” in Q1 Response.**

<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>

**As stated in our answer to Question 16, we strongly recommend adjusting the scope of transactions subject to penalties and settlement fails reporting for ESMA to focus actions on data that is truly relevant regarding settlement and financial risk aspects and remove e.g., the participants´ internal “housekeeping” activity from consideration in future.**

**Only then, an achievable and realistic level of efficiency may be jointly assessed by all stakeholders.**

**Note regarding point (c): as already discussed during the CSDR consultations about ten years ago, 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.**

**Please refer to “Introductory remark” in Q1 Response.**

<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>

**Please refer to “Introductory remark” in Q1 Response.**

**We also think that the idea of progressive penalty rates by value of the settlement fail could increase the risk of imbalances for CCPs in both directions (profit and loss) since there is usually a n:m relationship of members in an ISIN (e.g. one selling member has to deliver 100 securities to the CCP on an ISIN and the CCP has to deliver to two buying members, one with a volume of 80 and another with a volume of 20).**

<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>

**Please refer to “Introductory remark” in Q1 Response.**

<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>

**Please refer to “Introductory remark” in Q1 Response.**

<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.**

**Please refer to “Introductory remark” in Q1 Response.**

<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>

**Intentionally left blank.**

<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>

**Iberclear would prefer not** **make additional categories in line with answer included in “Introductory remark” in Q1 Response.**

**Being said that, we do not have no strong objections to consider bond-liquidity in the penalty calculation as long as the required data can be sourced the same way as done for shares already today (****i.e. using the ESMA FITRS database).**

**However, as ESMA states “The latest bonds quarterly liquidity assessment published on 31 October 202317 identifies 1,148 liquid bonds (sovereign and corporate ones) out of 124,197 bonds subject to MiFID II transparency requirements for Q3 2023, meaning that most of the bonds would be considered illiquid.”, we question the actual benefit of such approach as less than 1% of the bonds in scope would be “liquid” so we believe the cost/ benefit ratio is not convincing to justify such system change that would have to be implemented by any EU/ EEA CSDs and T2S.**

**We also repeat our strong recommendation for ESMA to centrally provide and publish all reference data needed to calculate penalties in a single database accessible to all stakeholders.**

<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>

**No, in line with “Introductory remark” in Q1 Response.**

<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>

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<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 “Introductory remark” in Q1 Response.**

<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>

**Iberclear consider that there are other actions/mechanism to support community settlement efficiency rates, therefore the penalty mechanism must not be applied only at the level of those CSDs with higher settlement fail rates as this would 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>

**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.**

<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>

**Please refer to “Introductory remark” in Q1 Response.**

<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, we do not consider that penalty rates should have a dependency on stock borrowing fees.**

<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>

**Please refer to “Introductory remark” in Q1 Response.**

<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>

**As repeatedly stated on various occasions including the ESMA workshop on settlement efficiency on 26th September 2023 (where DTCC and Euroclear UK presented their approaches being very different to EU CSDR) we cannot provide further information on the scope and methodology used for measuring settlement efficiency in third-country jurisdictions. Additionally, also mentioned by industry representatives during the ‘Roundtable on shortening the settlement cycle in the EU’ on 25th January 2024, the diverse structure of the EU securities markets, business models and legal rules cannot be compared with the ones of single local markets like the US or UK. Hence, Iberclear reiterates that it is merely impossible to compare settlement efficiency rates across global regions/ countries CSDs or partly even across EU CSDs. As a result, no reasonable “benchmarking” of EU CSDs versus third** **countries can be made.**

<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>

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<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>

**Given the variety of (structural and operational) reasons for settlement fails, Iberclear believe that, in line with “Introductory remark” in Q1 Response, the root causes for fails are not yet fully understood and actioned upon.**

**Hence, we have reasonable doubts that the increase of penalty rates would lead to more timely settlements overall.**

<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>

**As stated in the “Introductory remark” in Q1 Response, at this stage it is too early to consistently assess the outcome of the implementation of the SDR and it is essential, also in terms of planning, to consider the forthcoming scenario concerning the shortening of the settlement cycle. The implementation of the two initiatives in parallel seems counterintuitive and not manageable by the market in terms of project planning. Moreover, it must be considered that from the date of issuance of the final ESMA RTS, depending on the significance of the changes required, for CSDs (and T2S) internal developments and including testing with participants (and T2S), for** **low impact changes 2 years will be required. In case that changes are medium/high impacting, 3-4 years could be necessary.**

<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>

**Intentionally left blank.**

<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>

**Iberclear consider, firstly, that the idea to apply special penalties for participants with high settlement fails, seems both unfair and not helping to improve efficiency. Additionally, it can introduce an unexpected element for the calculation that would increase the complexity on calculation and allocation of these proposed higher penalties in line of the reasons that have been expressed in the “Introductory remark” in Q1 Response, where a change in the methodology would represent efforts and costs that would have to be assumed by all market actors with no proportionate return rate.**

**We cannot support an approach that is requiring to treat our participants differently and publicly brandmark them as “offenders” 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.**

<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>

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<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>

**Intentionally left blank.**

<ESMA\_QUESTION\_CSDR\_51>