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 | European Fund and Asset Management Association (EFAMA) |
| Activity | Associations, professional bodies, industry representatives |
| Are you representing an association? |  |
| Country / Region | Belgium |

# 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>

**General remarks**

EFAMA is pleased to respond to the consultation on the CSDR Cash Penalty Mechanism. We believe there is room to improve the effectiveness and targeted nature of cash penalties and would like to contribute positively to this review. We are however left a little doubtful on the timing, as more conclusive data is only just becoming available.

The consultation paper mentions a more detailed impact analysis to be published at a later stage. Data is also requested of CSDs on trends on settlement fails by asset class. Finally, CSDs are also requested to provide breakdown of data on the level of cash penalties (value and number) by asset type. All stakeholders are also invited to provide views on the level of settlement fails by asset type that they consider appropriate.

Given the level of data still requested and the fact that appropriate settlement fail rates are still under consideration (and rightfully so), it seems premature to start considering blanket introduction of progressive rates.

We have tried to compile datasets from various sources to understand the major settlement trends across asset classes. There is a clear lack of a single source of data to rely on. Given that data is not available from ESMA, it means that different market participants are looking at different data sources, making it difficult to make conclusions that are comparable and reliable.

This is further complicated by the fact that even the ESMA TRV data is difficult to compare across quarters, as the methodology has recently been revised.[[1]](#footnote-2)

Where we have had access to data we note that there is significant improvement on settlement fail rates in the second half of 2023. This points to the earlier quarters being less reliable given that a) H1 2022 the system was not stable yet and coincided with high market volatility b) on the behavioural side, there is a time lag between when a participant is facing high penalties and when decisions are made to upgrade systems and/or instill new processes to avoid fails.

We would feel more comfortable commenting on further calibration of cash penalties if there was a more reliable and significant look back period to base our recommendations on.

In summary to the current consultation questions, we can share the following high-level remarks:

* We believe that careful analysis of all the data available should precede any discussion on alternative methods for calculating cash penalties.
* There should also first be a general consensus on the appropriate level of fails per asset and transaction type, before attempting to amend cash penalties calculations. In the absence of agreed hard values, the trends observed since introduction of CPs can be relied on.
* Where settlement fails are known to be higher, a first level of analysis should establish whether fails are attributable to behaviour of market participants (and therefore to be addressed by cash penalties), or whether these are a function of structural issues which may require either a different view on desired settlement fail rates, or other types of mitigating measures (but not penalties), or both.
* Another priority should be to understand the root cause of different types of fails, and only propose progressive or higher rates in the strictest targeted manner, where there is a clear case for improving behaviour.
* Blanket introduction of progressive rates across asset types (even if differentiated) will introduce operational complexity and cost of implementation, with possibly no impact on fails if these are due to structural issues.
* The high rates proposed in the progressive rates model (600% or higher in some cases) could distort the market by reducing liquidity. This would impede rather than improve the smooth and orderly functioning of markets.
* **Positive impacts of US T1 migration**- market participants in the EU have undertaken investments into systems and processes to support confirmation/allocation and affirmation of US security trades on a T+1 basis. Some of this operational uplift could improve settlement fail rates in the EU also. This is another important impact that is still working through firms and has yet to be reflected in the settlement fail data.
* **Actionably avoidable**- we believe that this is a worthwhile concept that merits further analysis. Indeed not all settlement fails are equally avoidable, and flexibility where appropriate in the penalty mechanism should be allowed.

**Minimum cash penalties- Rather than introduce a blanket increase in flat penalty rates, we believe that a proportionate approach to minimizing operational burdens while preserving the deterrent impact of cash penalties would be to introduce a de-minimis value below which the CSD does not post penalties/credits. Under this approach, any penalties that are calculated by the CSD that come in below a designated threshold, would not be posted and passed on the settlement chain. The CSD could still report on the ‘penalties’/fails that fall below the threshold without passing them on.**

One large asset manager provided telling figures on a potential threshold.

88% of the credits received were below 500USD, and together they represented 17% of the overall value of all penalties

12% of the credits received were above 500USD, but they represented 83% of the overall value of all penalties.

This type of data point suggests that a threshold would have minimal impact on the deterrent aspect of cash penalties while reducing unnecessary operational burden.

## Data

We would appreciate access to the full dataset that ESMA has compiled and is basing its recommendations on. Ideally, a ‘golden source’ of data should be delivered from the CSDs to ESMA, and this data should be publicly available. This data should be more granular in terms of transaction and instrument type enabling in-depth assessment of the root causes of settlement fails.

Any reform of the cash penalties framework should only be explored if first an assessment has been undertaken to isolate fails due to:

* Structural causes (market fragmentation, market liquidity, cross-border cut-offs, inability to realign positions between different CSDs, market stress conditions)
* Behavioural reasons (problems with SSIs: late instructions, errors due to manual processes, missing securities on broker side and broker opting to fail)

Based on available data, we are observing positive trends, reported in the ESMA VRT on corporate bonds and equity instruments.

It is important that any further calibration of cash penalties avoids a catch-all scenario.

We agree in principle that ETFs should be treated as a separate category.

For ETFs, we should be asking what is the underlying exposure? Some of the underlying securities are more or less liquid. Any change to the framework that treats ETFs as a standalone category, should be calibrated to take account of the liquidity of the underlying assets.

## Improving the current infrastructure to reduce fails without necessarily modifying cash penalties (Partial settlement, hold and release)

A common issue for funds and asset managers is in accepting manual partials on trades that are already failing.

Given the buy-side typically have a longer settlement chain, they’re often second in inputting new shapes into the CSD and therefore suffer a late matching penalty, even though they’re agreeing to a partial for a broker that was previously insufficient.

We believe that ESMA and CSDs should establish a mechanism whereby the manual partialing of already failing trades carries the correct penalty allocation. CSDs could develop a methodology to link the cancelled original trade to the new split shapes, such that the penalty direction remains the same. This will encourage more manual partialing of stock. Failing to fix this, disincentivises partials that would have happened prior to cash penalty implementation.

Alternatively ESMA should mandate full auto-partial adoption by all CSDs and custodians, with any necessary opt-outs.

One of the I-CSDs is expected to support hold and release from June. But we are far from industry-wide support among CSDs of hold and release or auto-partial settlement. The same is true for custodians’ support for partial settlement. Making partial settlement mandatory could be part of the solution (though opt-outs under certain circumstances should be included).

## Simplicity is key

A well-functioning and efficient cash penalties system should be simple to apply. Any reform should not create more work for developers and increase the risk for errors. We should refrain from adding operational complexity. Our members tend to see progressive penalties as adding implementation costs in terms of complexity of systems, without necessarily reducing fails. And considering that there can be multiple counterparties along a single transaction chain, the pass-on mechanism will make the calculation and accuracy of that penalty charge even more complex and prone to error. This will also lead to increased bilateral claims, increasing costs for the buy-side.

We understand the appeal of progressive rates, but in practice we believe that they will constitute a blunt tool which will is unlikely to change behaviour, however high the rates.

## Penalty rates: how to discourage fails without creating a cottage industry for service providers around the management of fails claims

While we have seen some improvements in settlement fails since the introduction of cash penalties, a more finely calibrated regime could improve these further. In the current interest rate environment it is clear that with the penalties under CSDR ranging from 0.15 to 1.0 bps, there is less of an incentive to prevent a fail, as the remedy (borrowing securities/cash) is subject to much higher rates.

There is a fine balance to be achieved in moving away from a flat rate for penalties. If penalties are too heavy, the net impact might be reduced liquidity in the market with no visible impact on settlement fails.

A flat rate that is pegged to the funding rate, with perhaps an additional spread no greater than 0,5 bps-above this rate or with a floor, would discourage fails while ensuring that the option to fail is always costlier than to borrow securities. Can we consider a dynamic rate modelled on the US treasury TPMG model where both the impacts of a low or negative interest rate environment are mitigated, and penalty rates are still effective in high interest rate times?

If a dynamic cash penalty rate is adopted, we would expect ESMA to regularly review rate.

Please also see EFAMA’s response to question 26.

## Separate treatment for ETFs

On the ETF issuer side, EFAMA members would first and foremost like to review the available data on ETF fails with a view to ensuring that any changes to the cash penalty regime take account of the following:

* Detailed analysis and periodic publication of ETF settlement data by EEA CSDs must be made mandatory, to identify, delineate and attribute structural limitations versus behavioral drivers of ETF settlement.
* A more holistic focus on unit-lending markets, inter-operability of EU venues etc. is considered.
* Reflective of the market structure for ETFs where markets are fragmented and a single ETF will settle on a large number of CSDs, i.e a single ETF may trade and settle across 10 or more venues/CSDs. This natural fragmentation means an appropriate settlement fail rate may be different to standard equity fail rates. Where settlement is non-standardised and subject to primary and secondary market trades, a different settlement fail rate should apply.
* Targeting behaviour that can be actually deterred through cash penalties. Developing the concept of avoidable and intentional fails, and ensuring that cash penalties are not applied in a punitive and incremental way precisely where they will have only negative impacts: where fails are due to structural limitations, a punitive CP regime will only increase the trading cost and reduce liquidity in that asset class.
* Not having a detrimental impact on market liquidity, particularly for thinly traded or newly launched ETFs, or ETFs with earlier primary cut-off times.
* Penalty rates should be calibrated such that they incentivize the liquidity providers to make the necessary investments to avoid fails and the associated costs, without permanently removing liquidity from the market.
* Not increasing spreads, and hurting the global competitiveness of this market.

While some further calibration of cash penalties on ETFs may be in order, a more holistic analysis should be undertaken to see how settlement flexibility is appropriate for this asset class, and how best to target ‘actionably avoidable’ fails.

## Shortening the Settlement Cycle in Europe

Looking ahead to the EU’s possible move to shorten the settlement cycle to T1, we would like to warn against a complex and operationaly heavy adjustment to cash penalties, at the same time as the EU might be preparing for a shorter settlement cycle.

## Deminimis threshold

The buy-side has had to absorb the high costs of processing cash penalties and claims. In fact, in some jurisdictions buy-side firms are actually giving up penalties to custodians, given the high running costs of operationalizing penalties and the very small amounts that penalties actually represent.

There are numerous scenarios under which the CSD books the penalty in the wrong direction, causing the failing party to have to investigate and challenge the claim.[[2]](#footnote-3) Higher penalty rates, whether progressive or flat, would cause an increase in claims, as more penalties would exceed the industry standard of 500 USD for investigation. We would like to see ESMA prioritise this area, and explore ways in which cash penalty accuracy can be improved, to remove this additional cost borne by market participants.

The buy-side has previously articulated ideas around a deminimis threshold. There is an important distinction to be made here. The buy-side is supportive of a deminimis threshold, under which no cash penalties are generated and no debits flow through the system for amounts under a certain threshold. ESMA’s proposal appears to want to introduce higher rates starting on intended settlement date, followed by progressive rates.

We support a revised approach where penalties under a certain threshold are simply written off and do not flow through the settlement chain. This needlessly takes up resources, without any clear deterrent effect. This is without prejudice to a potential increase in a flat-rate cash penalty which is pegged to a funding rate. We would also recommend that a liability analysis, checking of all settlement fails can still take place at the CSD level to spot out any systematically failing counterparties who happen to fall under the threshold most of the time.

<ESMA\_QUESTION\_CSDR\_1>

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

<ESMA\_QUESTION\_CSDR\_2>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_3>

1. What costs and benefits do you envisage related to the implementation of each Option? Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA\_QUESTION\_CSDR\_4>

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

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_4>

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

<ESMA\_QUESTION\_CSDR\_5>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_5>

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

<ESMA\_QUESTION\_CSDR\_6>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_6>

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

<ESMA\_QUESTION\_CSDR\_7>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_7>

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

**a)92 business days;**

**b)40 business days;**

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

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

<ESMA\_QUESTION\_CSDR\_8>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_8>

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

<ESMA\_QUESTION\_CSDR\_9>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_9>

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

<ESMA\_QUESTION\_CSDR\_10>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_10>

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

<ESMA\_QUESTION\_CSDR\_11>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_11>

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

<ESMA\_QUESTION\_CSDR\_12>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_12>

1. What costs and benefits do you envisage related to the implementation of the approach proposed by ESMA? Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA\_QUESTION\_CSDR\_13>

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

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_13>

1. If applicable (if you have suggested a different approach than the one proposed by ESMA), please specify the costs and benefits you envisage related to the implementation of the respective approach. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA\_QUESTION\_CSDR\_14>

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

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<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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 vast majority of settlement fails are caused by brokers/dealers, and not by the fund industry, as we are typically on the long-side only.

As asset managers, the main reasons for failing to deliver securities is generally because of Standard Settlement Instructions (SSI) mismatches or differences on economic data (data quality being a high prerogative for settlement efficiency). Another reason could also be because of positions that need to be realigned from one market to another due to a split of positions.

The main reason for failure to deliver cash on the other hand is because of the failure of a funding trade higher up the chain leaving no cash available.

It should however be noted that asset managers are generally recipient of positive penalties, and the principal cause of a trade failing is usually when the broker is short because of a lack of securities. <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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

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<ESMA\_QUESTION\_CSDR\_20>

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

<ESMA\_QUESTION\_CSDR\_21>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_21>

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

<ESMA\_QUESTION\_CSDR\_22>

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<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

Progressive rates were not welcomed by the EFAMA membership due to:

* Lack of a use-case, i.e would they really contribute to a further reduction in fails.
* Related to the point above, we are lacking quality, granular public data on settlement fails and the underlying causes.
* We believe that the existing framework may still have some positive impact to deliver. The look-back period today is not long enough.
* Cost of implementation and undue complexity makes the system more prone to error, and claims handling.

What can be useful, and to some degree is already occurring due to the US T1 move, is the updake of greater automation, the harmonisation of platforms and the instantaneous exchange of data.

Furthermore, for any mechanism to work effectively it needs to be flexible in terms of the rates applied. For instance, we must be able to react quickly in case of new market conditions and if we observe that the rate applied are disproportionate given the objective to be achieved.

Finally, and as proposed in our introduction, if in-depth analysis of settlement fail data does show a need to reform the cash penalties regime, we believe that a dynamic rate pegged to the market funding rate should be considered. Although asset managers do not borrow, for rates to be sufficiently dissuasive for some parties, a probable change could be to link them to the cost of borrowing securities (slightly higher).

Please see our comments under General Remarks also.

**As mentioned in our introduction, we support revisions to the framework that would treat ETFs as standalone category for the application of fail penalties –**

1. We also support ESMA’s proposal to increase the current settlement penalty charges, as an effective disincentive against “actionably avoidable” fails.
   1. However, we believe the potential costs associated with the proposed charges is disproportionately higher than the perceived benefits.
2. We recommend ETF fail penalties must be benchmarked to the current overnight interbank financing rate (such as ESTR) along with a small spread or a floor. This rate must be calibrated based on joint discussion between ESMA and brokers.
   1. We discourage the use of any other benchmark such as ETF stock borrow charges.
3. We do not support the proposal for progressive penalties in the ETF category either.
   1. Our analysis suggest a high volume of ETF orders are settled within 3-4 days of trade execution and progressive increase in penalties are unlikely to have any meaningful impact on expediting settlement.
   2. Instead, we recommend ESMA to have a flat rate of penalty.
4. A more detailed analysis of ETF settlement fails must be carried out to understand and delineate various issues underlying ETF settlement fails.
   1. To this effect, we recommend that ESMA make public the current mandatory reporting of ETF settlement data by EU CSDs.
5. We also recommend a periodic review – every 6 or 12 months – of the settlement efficiency and the impact (and any changes) to current penalty regime.
   1. Such a review will also help ESMA calibrate an appropriate roadmap to accelerating the settlement cycle for EU capital markets.

<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>

TYPE YOUR TEXT HERE

<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 |

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<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>

TYPE YOUR TEXT HERE

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

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_29>

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

<ESMA\_QUESTION\_CSDR\_30>

TYPE YOUR TEXT HERE

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

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_30>

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

<ESMA\_QUESTION\_CSDR\_31>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_31>

1. Would you be in favour of the use of the market value of the financial instruments on the first day of the settlement fail as a basis for the calculation of penalties for the entire duration of the fail? ESMA would like to ask for the stakeholders’ views on the costs and benefits of such a measure. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA\_QUESTION\_CSDR\_32>

TYPE YOUR TEXT HERE

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

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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 |

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<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>

As previously stated, the level of penalty rates should take this into consideration, and should be supplemented by broader market changes that help to ensure that parties are not incentivised to delay settlement.

We can understand the proposed logic behind the question. However, funds even if they are often the net receiver of penalties, have an over-riding interest in seeing an improvement in settlement efficiency. In practice, we do not expect to see such behaviour:

* MiFID II’s best execution regime requires firms to take all reasonable steps to obtain the best possible result for their clients taking into account notably, price, costs, speed and likelihood of execution and settlement of the order (MiFID II, art. 27)
* Ultimately, such behaviour could lead to some brokers exiting the market, which would be to the detriment of asset managers and available liquidity.
* There is still an operational burden connected on the management company to process penalties and claims

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_39>

1. Please specify what costs and benefits you envisage regarding the application of the penalty mechanism only at the level of the CSDs with higher settlement fail rates. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA\_QUESTION\_CSDR\_40>

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

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

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

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_41>

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

<ESMA\_QUESTION\_CSDR\_42>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_42>

1. Do you have other suggestions to simplify the cash penalty mechanism, while ensuring it is deterrent and proportionate, and effectively discourages settlement fails, incentivises their rapid resolution and improves settlement efficiency? Please justify your answer and provide examples and data where available. Please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA\_QUESTION\_CSDR\_43>

TYPE YOUR TEXT HERE

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

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_43>

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

<ESMA\_QUESTION\_CSDR\_44>

Cross market comparisons are very difficult to make. In the US, the trading, clearing and settlement is concentrated in a few financial market infrastructures, and there is no regime in force comparable to the CSDR. In Europe on the other hand, we have many CSDs, CCPs, currencies, a principle of irrevocability, which complexifies the whole settlement process. It is also quite complicated to conduct a clear assessment of the current settlement efficiency as there is no universal methodology.

However, this conclusion points to the need to rationalise our market to make it simpler, more interconnected and automate our processes as far as possible. In Europe, we still rely too much on counterparties proactively communicating and agreeing the place of settlement to reduce the likelihood of any mismatches.<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>

TYPE YOUR TEXT HERE

<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>

Minimum value cash penalties-. We do not support a ‘minimum penalty of this sort. We believe that setting minimum penalty rates across all types of fails is not a good idea as it doesn’t take into account the size of the trade i.e. big or small orders, block trades and individual trades. It would incur big development for a hypothetical purpose. Moreover, setting a minimum penalty rate completely ignores the root cause of the fail.

**A de-minimis threshold set at CSD level- We would welcome an alternative approach with a de-minimis at which the CSD withholds cash penalties where the value of a cash penalty does not reach a certain value (e.g. nothing below a given value is posted)**

ESMA should explore a model whereby for immaterial cash penalties, the CSDs withhold the credit and debit to CSD participants given the operational cost of processing such small values would likely exceed the value of the penalty itself.

We appreciate the challenges in this, but think blocking low value penalties would satisfy the proportionality element of the CSDR consultation.

We support the analysis and conclusions contributed by the IA in this regard.<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>

We cannot provide estimates on the time it will take to implement changes unless we know the nature of the changes to be implemented. However, it is clear that a simple penalty mechanism like we have today is preferable. It is easily understood, implemented and reviewed. Any future change to the penalty regime should be properly sequenced to avoid clashing with other potential changes (i.e EU shortening of the settlement cycle, and to give firms sufficient time to upgrade systems and processes.

<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>

TYPE YOUR TEXT HERE

<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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_49>

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

<ESMA\_QUESTION\_CSDR\_50>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_50>

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

<ESMA\_QUESTION\_CSDR\_51>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_51>

1. [ESMA50-524821-3107 Report on Trends, Risks and Vulnerabilities, n.1, 2024 (europa.eu)](https://www.esma.europa.eu/sites/default/files/2024-01/ESMA50-524821-3107_TRV_1-24_risk_monitor.pdf) [↑](#footnote-ref-2)
2. [www.afme.eu/Portals/0/CSDR%20Settlement%20Discipline%20-%20Bilateral%20Penalty%20Claims%20August%202021.pdf](http://www.afme.eu/Portals/0/CSDR%20Settlement%20Discipline%20-%20Bilateral%20Penalty%20Claims%20August%202021.pdf) [↑](#footnote-ref-3)