

# 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](http://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](#)'.

## **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.

## 1 General information about respondent

Name of the company / organisation	Bundesverband der Wertpapierfirmen (bwf)
Activity	Associations, professional bodies, industry representatives
Are you representing an association?	<input checked="" type="checkbox"/>
Country / Region	Germany

## 2 Questions

**Q1 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>

- bwf and its members support industry and regulatory efforts to improve settlement efficiency in EU markets.
- We also welcome simplification and predictability of penalties.
- However, it is important to understand the causes of settlement fails in order to decide upon the right tools and incentives to address them.
- The cause of settlement fails can be categorized as: 1. Behavioural fails (where parties intend or at least accept to fail), 2. Fails due to error (eg mis-bookings, late confirmations), 3. Structural fails (cross-border cut-off times, corporate actions, trading or settlement restrictions, underlying market liquidity)
- Higher penalties are not capable of solving structural issues (especially for intermediaries) “If you can’t get the securities, you can’t get the securities”, in this case we strongly advocate an extended period of low or at least moderate penalties.

- For behavioral issues the natural costs of failing are the most relevant factor. Please see the experiences of TMPG in the US.
- It is important to mention that higher penalties can also create adverse behavioral incentives. In particular if cash penalties received as a result of being failed would exceed the anticipated potential returns by actually holding the security.
- Such adverse incentives would jeopardize the aim of higher partial settlements to improve settlement quality and quantity. Higher penalties therefore would clearly undermine initiatives to increase partial settlements in situations where in time full settlement is not possible.
- More work needs to be done on identifying the causes of settlement fails in particular in the EU bond markets, with a focus on targeted and proportionate tools to address these.
- There may be a more convincing argument for higher penalties if/when we return to a low interest rate or negative interest rate environment, particularly if we see an increase in settlement failures. However, a minimum penalty would be likely to sufficiently address such a problem. Accordingly, the proposed multiples of up to 30 would be clearly disproportionate. The penalty rates proposed under Option 4 would be extreme and in consequence a violation of the “proportionality principle”, and most likely a regulatory failure. As mentioned before, a minimum penalty rate in our view seems to be more appropriate in such a situation and would avoid the problems resulting from the proposed high multiples of up to the factor of 30.
- The magnitude of proposed increased penalty rates is extreme, lacks empirical evidence of efficiency, is not supported by any convincing economic reasoning. In the contrary, it would be highly distortive with adverse impacts for market liquidity and pricing. This would create additional costs for investors in the secondary market and issuers in the primary market, making the EU less competitive compared to its global peers.
- A consistent definition of settlement fails and transparent metrics of settlement rates across different asset classes would be necessary in order to assess the impacts of various factors which could improve settlement efficiency in the EU, without narrowing the focus on cash penalties.
- Settlement discipline measures also need to be assessed in the context of the EU’s political intention to shorten settlement cycles to “T+1”, which will likely have direct impacts on settlement efficiency, particularly in less liquid or cross-border markets, such as bonds.

- bwf therefore remains sceptical whether the proposals made are sufficiently justified and appropriate.

<ESMA\_QUESTION\_CSDR\_1>

**Q2 Do you have other suggestions? If yes, please specify and provide arguments.**

<ESMA\_QUESTION\_CSDR\_2>

- For intermediaries who provide liquidity to the market by trading on own account or in “any other trading capacity”, settlement risks might arise in different forms and in areas. E.g. partial settlement might be available only on one side of the trade, but not the other. Often (in particular in cross boarder trading) penalties cannot be passed on to the market participant who initially is causing the fail. Therefore, an exemption or at least a significant relief from cash penalties for intermediaries like market makers/liquidity providers should be considered. The other way round, if penalties become prohibitive the market quality and liquidity will deteriorate significantly as a result of reduced or even ceased market maker support which might also lead to lower overall trading levels.

Specifics of “late matching fail penalties”

- In particular late matching fail penalties, resulting from delayed matching of settlement instructions after a CSD’s “cut off time”, have the potential to punish the wrong party within a chain of failed settlements.
- Settlement is based on standing settlement instructions (SSIs), which should be contractually agreed prior to a trade being executed. When these SSIs are subject to changes (not being updated prior to trade) or are simply incorrect or the traded instruments are simply not at the dedicated depository, both parties can agree on adjusting the exchanged SSIs after the intended settlement date to be able to process the settlement as soon as possible.
- Within this adjustment process, there is a certain probability, that the party, who is originally responsible for causing the failed settlement by simply having provided incorrect SSIs, will not be held responsible for causing the late settlement but the misinformed party will de facto be compelled to adjust their instructions.

- A stronger regulatory awareness and appropriate action regarding such observed LMFP-practices, e.g. flagging the responsible party causing the late matching or simply eliminate the late matching penalties, would be highly appreciated.

<ESMA\_QUESTION\_CSDR\_2>

**Q3 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>

Here we largely agree with the comments of our colleagues from ICMA and adopt some of their arguments. However, in the course of ESMA’s feedback assessment, our answer should be weighted as an individual stakeholder contribution.

- In the case of penalties for insufficient cash, the basis of “proportionality” would imply that the shortest available official central bank policy rate for the relevant currency, or a proxy rate based on publicly available money market rates should be applied, consistent with the ECSDA guidelines.

<ESMA\_QUESTION\_CSDR\_3>

**Q4 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
<b>Benefits</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

<b>Compliance costs:</b> - One-off - On-going	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Costs to other stakeholders</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Indirect costs</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

- Please refer to our answers to Qs 1-3 which outline, very clearly, why it seems not convincing to spend a lot of time and expense in order to replace a methodology that already serves sufficiently well the original regulatory intent, just to address problems regarding a relatively small subset of all transactions settled on EU (I)CSDs.
- As outlined in our response to Q1, EMSA's Option 4 should be dismissed unless the intention of the proposal is to simulate market conditions experienced under extreme market stress.

<ESMA\_QUESTION\_CSDR\_4>

**Q5** 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>

**Q6 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>

**Q7 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>

**Q8 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>

**Q9 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>

**Q10 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>

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<ESMA\_QUESTION\_CSDR\_10>

**Q11 Do you have other suggestions? If yes, please specify, provide drafting suggestions and provide arguments including data where available.**

<ESMA\_QUESTION\_CSDR\_11>

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<ESMA\_QUESTION\_CSDR\_11>

**Q12 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>

**Q13 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
<b>Benefits</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Compliance costs:</b> - One-off - On-going	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Costs to other stakeholders</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Indirect costs</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_13>

**Q14** 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
<b>Benefits</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Compliance costs:</b> - One-off - On-going	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Costs to other stakeholders</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Indirect costs</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_14>

**Q15** 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>

Here we largely agree with the comments of our colleagues from ICMA and adopt some of their arguments. However, in the course of ESMA's feedback assessment, our answer should be weighted as an individual stakeholder contribution.

- In a normal interest rate environment, failing is expensive.
- As a general rule, there is little or no economic incentive to fail on the settlement of a securities transaction.
- Penalties are therefore an add-on to the natural cost of failing. Compare TMPG (Treasury Market Practices Committee) penalty charges applied to settlement fails in the US Treasury market since May 2009.
- bwf would further attribute the observed improvement in settlement efficiency rates in the EU to a much greater industry-wide focus on settlement processes and operational efficiency as a consequence of the introduction of CSDR, and therefore an indirect outcome of settlement discipline.
- One could argue that the threat of mandatory buy-ins, along with the roll-out of cash penalties, have already provided the desired effect of reducing the number of settlement fails caused by error, even if the former is never implemented and the latter loses its relevance in a normal rate environment.

<ESMA\_QUESTION\_CSDR\_15>

**Q16 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>

Here we largely agree with the comments of our colleagues from ICMA and adopt some of their arguments. However, in the course of ESMA's feedback assessment, our answer should be weighted as an individual stakeholder contribution.

- bwf would refer the arguments and analysis presented in the response to Q15, as well as the importance of recognizing the causes of fails when considering the appropriate calibration of a penalty mechanism, or indeed whether it is even necessary.
- Given that the observed improvement in EU settlement efficiency rates correlates closely with higher interest rates (the natural cost of failing), it could be argued that at current interest rate levels, and given the ongoing industry efforts to improve settlement processes and operation

efficiency, a penalty mechanism is effectively redundant at the current, relatively high, interest rates. So, in this respect, it could be argued quite legitimately that the existing penalty rates, with respect to bonds, are indeed proportionate and that raising them in the current interest rate environment would have little or no effect in reducing settlement fails further.

- What the observations in the data seem to suggest is that the current penalty rates may be too low in a lower interest rate environment. A minimum penalty rate could solve that issue easily but those rates do not need to be extreme or multiples of actual rates.
- Bwf and its members would encourage ESMA to focus its attention on the structural causes of fails, which cannot easily or effectively be addressed by higher interest rates or settlement discipline measures.

<ESMA\_QUESTION\_CSDR\_16>

**Q17 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>

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<ESMA\_QUESTION\_CSDR\_17>

**Q18 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>

- It would be desirable if authorities would better monitor data on settlement failures. This includes also removing exemption from short selling reporting obligations

<ESMA\_QUESTION\_CSDR\_18>

**Q19** 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>

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<ESMA\_QUESTION\_CSDR\_19>

**Q20** 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>

**Q21** 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>

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<ESMA\_QUESTION\_CSDR\_21>

**Q22** 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>

Here we largely agree with the comments of our colleagues from ICMA and adopt some of their arguments. However, in the course of ESMA's feedback assessment, our answer should be weighted as an individual stakeholder contribution.

- bwf and its members see no logical or economic basis for progressive penalties.
- There is normally a natural cost to failing which should address behavioural fails or those caused by errors.
- Failing is expensive
- If the natural cost of failing is too low (such as in a close-to-zero or negative interest rate environment), then this can be replaced or supplemented by applying penalties or a minimum rate.
- Progressive penalty rates introduce unnecessary stress to a market that is most likely already facing liquidity challenges.
- Progressive penalty rates would not provide an additional motivation to settling trades, but rather an incentive to avoiding trades, thereby becoming counterproductive.
- Increasing the cost of failing will not make an illiquid security any less illiquid; this will only make illiquid securities more illiquid.
- A further unintended consequence of progressive rates, as recognized by ESMA in its 2015 Technical Advice under the CSDR,<sup>1</sup> is that it would undermine the principle of immunization with relation to chains of interdependent transactions. The current design of the penalty mechanism ensures that a participant in the middle of a chain will receive the same amount as that it would pay as a penalty. While incentivising each intermediary in the chain to take action to cure the fail this provides for a way to limit the negative effect the penalty because the amount received and paid are the same.
- Finally, progressive penalties would introduce an unnecessary level of complexity, with the associated cost and resource drain, not only for implementing CSDs, CCPs, and custodians, but also market participants who need to reconcile penalty credits and debits, as well as pass these

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<sup>1</sup> See: [https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1219\\_-\\_final\\_report\\_csd\\_r\\_ta\\_incl\\_cba\\_for\\_ec.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1219_-_final_report_csd_r_ta_incl_cba_for_ec.pdf)

[https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1219\\_-\\_final\\_report\\_csd\\_r\\_ta\\_incl\\_cba\\_for\\_ec.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1219_-_final_report_csd_r_ta_incl_cba_for_ec.pdf)



on to clients. Furthermore, this would put additional stress on an already dysfunctional claims process that has been born out of the EU's CSDR penalty mechanism.

<ESMA\_QUESTION\_CSDR\_22>

**Q23 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>

Here we largely agree with the comments of our colleagues from ICMA and adopt some of their arguments. However, in the course of ESMA's feedback assessment, our answer should be weighted as an individual stakeholder contribution.

- bwf and its members fail to understand the rationale for introducing convexity to the penalty mechanism.

<ESMA\_QUESTION\_CSDR\_23>

**Q24 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>

Here we largely agree with the comments of our colleagues from ICMA and adopt some of their arguments. However, in the course of ESMA's feedback assessment, our answer should be weighted as an individual stakeholder contribution.

- illiquid instruments such a rule could further decrease liquidity in specific markets. The willingness to provide liquidity might sink.

<ESMA\_QUESTION\_CSDR\_24>

**Q25 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>

Here we largely agree with the comments of our colleagues from ICMA and adopt some of their arguments. However, in the course of ESMA's feedback assessment, our answer should be weighted as an individual stakeholder contribution.

- The rates proposed under both Option 1 and 2 are extremely disproportionate to the point of being irrational.
- bnf would be very interested to understand what points of reference ESMA used in determining these levels or any analysis undertaken with respect to the relative cost of these penalties.
- It is important to recognize that if these proposed progressive penalty rates were ever applied, this would have serious implications for market pricing and liquidity, making the EU capital markets significantly less attractive to investors and issuers compared with its global peers.
- The proposed rates are utterly disproportionate.
- In the same way that repo or borrow rates are effectively factored into the price of underlying securities, the cost of failing can also be viewed as an unintended 'borrow cost': essentially, the natural cost of failing (current money market interest rates) plus any additional penalties. In the same way that extreme borrow costs can be highly price distortive, so would extreme penalties.
- Similar to the notion of MBIs, anything that systematically distorts markets by creating disproportionate costs and risks to participants will also create adverse behavioural incentives. In the case of these proposed rates that increase, significantly, every day, being failed-to becomes immensely profitable. In fact, in many cases, the economic benefit from not receiving a security will be greater than the returns from the security itself.
- This could make the proposals self-defeating, creating counterproductive outcomes to the current industry and regulatory efforts to improve settlement efficiency in the EU.
- Partial settlement is an important settlement initiative to reduce fails. In the case that the selling party is unable to deliver the full quantity of securities, the purchasing party accepts

whatever securities they can deliver, and continues to do so until they receive the full amount. Thus, the settlement will only fail for the quantity of securities for which the selling party is insufficient. Extreme penalties, however, create a string incentive for the purchasing party not to accept partial delivery, and to wait for full delivery, assuming that they have no matching onward delivery themselves. This would allow them to make very high returns from ESMA's proposed penalty rates, while still enjoying the benefit of owning the undelivered securities. Furthermore, every day the fail persists, their profits increase exponentially.

- For the same reason as not accepting partial settlement, the proposed penalty rates a disincentive for the purchasing party to agree to 'shaping', which is the practice of splitting large trades into smaller ticket sizes in order to reduce the risk of the entire trade failing. With the penalty rates being proposed, and assuming there is no matching onward delveiry, the purchasing party will want to increase the chances of being failed to as much as possible.
- The incentive to use buy-ins also diminishes in the case of extreme penalties. Buy-ins are widely used in the cross-border non-cleared bond markets to force delivery of a failing transaction (or, more accurately, replace the settlement). Buy-ins do not create any additional economic gains for the non-failing party, beyond the economics of the original transaction (they are effectively made whole).<sup>2</sup> However, given the excess profits generated by being failed to, the purchasing party may decide that these more than compensate for the counterparty credit risk from the fail, and hold-off on initiating a buy-in, especially if they are the final party in the transaction chain.

<ESMA\_QUESTION\_CSDR\_25>

**Q26 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>

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<sup>2</sup> Buy-ins do, however, usually generate a cost to the failing party. This is due to the securities being bought at an above market price in the buy-in process.

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_26>

**Q27 What are your views regarding the categorisation of types of fails:**

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

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

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

<ESMA\_QUESTION\_CSDR\_27>

- The rationale and guiding concept of option 2 for progressive penalty rates due to lack securities is not yet sufficiently clear. From the wording one could assume that ETFs would fall into the second category which overall comprises “non-liquid-assets”. Clarification is needed if this is the regulatory intent or if ETFs should be separated into liquid and non-liquid assets according to the transparency regime?

<ESMA\_QUESTION\_CSDR\_27>

**Q28 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>

<b>Progressive penalty rates (by asset type) - ESMA’s proposal Option 1</b>	<b>Please see ESMA’s proposed Option 1 in Section 5.3 of this CP.</b>	
	<b>Qualitative description</b>	<b>Quantitative description/ Data</b>
<b>Benefits</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

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

- Broad estimates by bwf members based on empirical trade data suggest that the net effects of additional costs resulting from increased cash penalties would reach a magnitude of 1200 percent (multiple of 13 – sic!) compared to current levels.

<ESMA\_QUESTION\_CSDR\_28>

**Q29** 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

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

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<ESMA\_QUESTION\_CSDR\_29>

**Q30** 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>

- rates shall be proportionate to the value of the settlement. One could only think about a minimum penalty rate as lower bound if to keep the incentive to mitigate even very small failures

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

<b>Costs to other stakeholders</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Indirect costs</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_30>

**Q31** 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>

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<ESMA\_QUESTION\_CSDR\_31>

**Q32** 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

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

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_32>

**Q33 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>

**Q34 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>

**Q35 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
<b>Benefits</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Compliance costs:</b> - One-off - On-going	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Costs to other stakeholders</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Indirect costs</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_35>

**Q36 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>

**Q37 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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_37>

**Q38 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>

**Q39 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>

**Q40** 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
<b>Benefits</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Compliance costs:</b> - One-off - On-going	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Costs to other stakeholders</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
<b>Indirect costs</b>	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_40>

**Q41 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

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

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_41>

**Q42 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>

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<ESMA\_QUESTION\_CSDR\_42>

**Q43 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

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

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CSDR\_43>

**Q44** 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>

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<ESMA\_QUESTION\_CSDR\_44>

**Q45** 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>

**Q46** Do you consider that introducing a minimum penalty across all types of fails would improve settlement efficiency? If 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>

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<ESMA\_QUESTION\_CSDR\_46>

**Q47** 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>

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<ESMA\_QUESTION\_CSDR\_47>

**Q48** 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>

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<ESMA\_QUESTION\_CSDR\_48>

**Q49** 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>

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<ESMA\_QUESTION\_CSDR\_49>

**Q50** 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>



**Q51** 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>

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<ESMA\_QUESTION\_CSDR\_51>