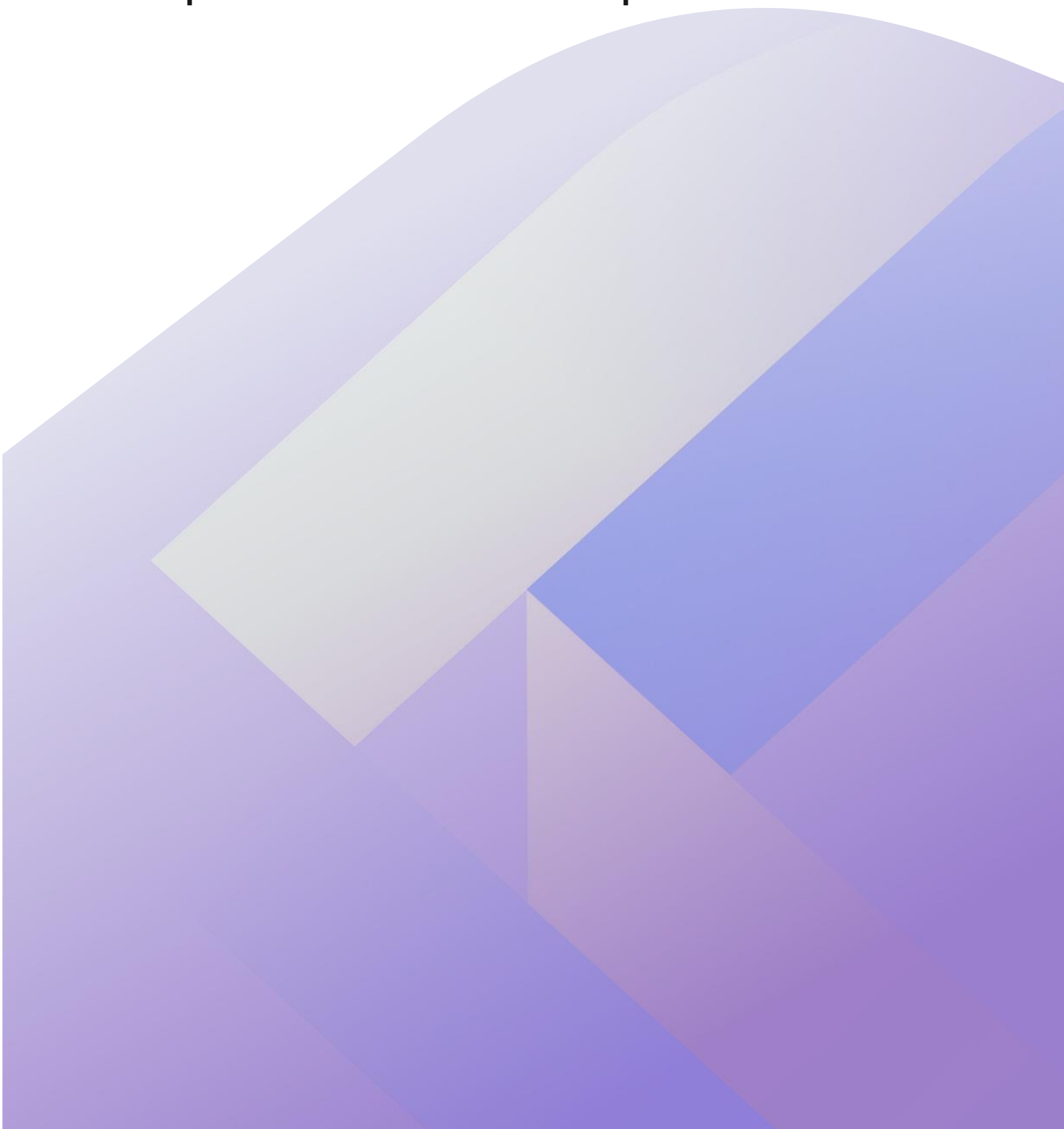![ESMA - European Securities and Markets Authority]

Reply Form

to the Consultation Paper on Technical Advice on the Scope of CSDR Settlement Discipline

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 **9 September 2024.**

All contributions should be submitted online at 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_SETD_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_ SETD_nameofrespondent.

  For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA_CP1_ SETD_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 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	Association for Financial Markets in Europe (AFME)
Activity	Other
Are you representing an association?	☒
Country / Region	Europe

2 Questions

Q1   Do you agree with ESMA's proposal regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions? Please specify which cases you agree with and which cases you don't agree with (if applicable). Please justify your answer and provide examples and data where available.

<ESMA_QUESTION_SETD_1>

AFME members are generally supportive of measures to refine the scope of the cash penalties regime. We believe that a key principle of the cash penalty mechanism should be that market participants do not suffer economic loss for settlement fails that occur as a result of circumstances outside of their control.

We note that the consultation appears to envisage a single scope of application for the settlement discipline regime (i.e. settlement fails reporting, cash penalties, and mandatory buy-ins (MBIs)). We agree that settlement fails not subject to cash penalties should not be included in settlement fails reporting. We also agree that settlement fails not subject to cash penalties should also not be subject to MBIs, should a MBI regime be reintroduced by legislators. However, AFME members believe that, in the case of MBIs, additional transactions should be exempted from the regime where a buy-in would serve no purpose or would be damaging to the functioning of the market. We therefore strongly encourage that, in the future event that the introduction of MBIs is reconsidered, a separate consultation is issued prior to MBI implementation to identify additional scenarios which should be out of scope specifically of the MBI regime.

With regards to the reporting of settlement fails, judging from the information made available by CSDs and the ECB to their participants, it is evident that current fail reporting parameters and the methodology deployed differs across the CSD community, even between CSDs belonging to the same group. Collectively, this leads to ambiguity and a distorted view of settlement fails. AFME will be looking forward to providing input for the configuration of a common methodology for the reporting of settlement fails in an expected future ESMA consultation. AFME agrees in principle with ESMA that the six scenarios listed below should not be subject to settlement discipline rules (including settlement fails reporting, cash penalties and MBIs).

- ISIN suspension from settlement
- ISIN suspension from trading
- settlement instructions involving cash settlement outside the securities settlement system operated by the CSD if, on the respective day, the relevant payment system is closed for settlement
- technical impossibilities at the CSD level that prevent settlement
- settlement instructions involving securities under sanctions or anti-money laundering proceedings
- settlement instructions put on hold due to the order issued by a court, the police or similar authority with relevant mandate.

<ESMA_QUESTION_SETD_1>

Q2 ESMA would like to ask for the stakeholders' views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions). 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's proposal - underlying causes of settlement fails that are considered as not attributable to the participants in the transactions		
	Qualitative description	**Quantitative description/ Data**

Benefits		
Compliance costs: - One-off - On-going		
Costs to other stakeholders		
Indirect costs		

<ESMA_QUESTION_SETD_2>

ESMA's proposal - underlying causes of settlement fails that are considered as not attributable to the participants in the transactions		
	Qualitative description	**Quantitative description/ Data**
Benefits	Efficiency: Avoids the generation and processing of cash penalties which will not incentivise improved settlement efficiency. Clarity: Provides greater certainty on the scope of application of cash penalties.	
Compliance costs: **- One-off** **- On-going**	Changes to systems: CSDs will need to make updates to penalty calculation mechanisms. These same changes will need to be replication by other market participants who are predicting/monitoring penalties.	
Costs to other stakeholders		
Indirect costs	Potential increase in appeals / manual processing: If all	

	scenarios cannot be systemically excluded ex-ante from cash penalties calculations, there is likely to be an increase in appeals to CSDs, creating additional work for all stakeholders.	

<ESMA_QUESTION_SETD_2>

Q3 **Do you have other suggestions regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions? Please justify your answer and provide examples and data where available.**

<ESMA_QUESTION_SETD_3>

We consider that a practical example is CSD-generated instructions. Where the instruction is created by the CSD itself with a back-dated intended settlement date, it is clearly outside the control of the participants. Neither participant can be fairly penalised for the failure to settle on intended settlement date.

However, we note that the typical examples of CSD-generated instructions, such as market claims, are generally captured by ESMA as scenarios deemed operations not considered as trading.

<ESMA_QUESTION_SETD_3>

Q4 **If you have answered yes to the previous question, 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.**

Respondent's proposal (if applicable)		
	Qualitative description	**Quantitative description/ Data**
Benefits		
Compliance costs:		

- One-off		
- On-going		
Costs to other stakeholders		
Indirect costs		

<ESMA_QUESTION_SETD_4>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_SETD_4>

Q5   Do any of the exemption proposed above breaks the immunization principle? Please provide arguments.

<ESMA_QUESTION_SETD_5>

We note that as soon as exemptions are not evenly applied to all settlement instructions, there is a risk that the immunisation principle will be breached. Typically, this would be in cross-border scenarios, whereby offsetting transactions are instructed for settlement at different CSDs.

By way of example:

Example 1: Sanctions regulation could be interpreted or applied differently by different CSDs.

Example 2: A CSD-specific technology issue could prevent settlement at one CSD, whilst other CSDs operate as normal.

We note that all matched instructions will remain in the T2S platform for 60 days from the last modification on any matching field, after which they will be cancelled if not settled. We consider that this timeframe is too long and puts added pressure on the platform. We would recommend for the timeframe to be reviewed following the European Commission's FASTER initiative.

<ESMA_QUESTION_SETD_5>

Q6 **Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which ones can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs?**

Please provide details regarding the cost for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

<ESMA_QUESTION_SETD_6>

AFME generally considers that for all 6 scenarios, in most circumstances it should be possible to apply the exemptions systemically, automatically and on an ex-ante basis. One notable exception could for settlement instructions put on hold due to the order issued by a court, the police or similar authority with relevant mandate. In many such cases, it is likely that the participant to the transaction would be the party putting the instruction on hold, and the CSD would have no visibility of the underlying reason for the hold. In this case, we envisage it will be necessary to resolve this through the CSD appeals process.

In general, the industry aspiration should be to minimise the number of appeals sent to the CSDs. This process is highly manual, inefficient and time-consuming for all parties. Therefore, there is a strong preference from AFME members for exemptions to be applied ex-ante. If exemptions cannot be applied in the calculation stage, we recommend that CSDs conduct "Quality Control" to remove erroneous penalties before they are reported to participants. Similarly, in cases where an appeal is upheld by a CSD, it should be the responsibility of the CSD to identify any other instructions that should be exempted for the same reason, and to systematically remove erroneous penalties (regardless of whether an appeal has been raised in relation to that specific instruction.)

In regards to the proposed exemption due to ISIN suspension from trading: We note that, while it sounds logical for this exemption to be applied, there are still technical questions on how to deal with it from an operational and regulatory perspective. Indeed, CSDR requires the application of penalties as soon as the ISIN is in the FIRDS database, which is fed by all the trading venues / systematic internalisers which admit / trade the ISIN. Thus, such exemption, in order to remain consistent with CSDR, would require for the ISIN to no longer be listed / traded at all. In other words, there shall be no more occurrence of the ISIN in FIRDS. If not, this means corrections will have to be done ex-post.

<ESMA_QUESTION_SETD_6>

Q7   For exemptions that can be filtered out in advance, do you think that a CSD would prefer to implement this filter or not? Also considering the very large number of appeals they might have to deal with and also the costs it will entail.

<ESMA_QUESTION_SETD_7>

As noted in our response to Q6, the appeals process is highly manual, inefficient and time-consuming for all parties. The timeline for rectification of cash penalties is already relatively constrained, where the appeal and the correction need to be achieved before the payment date.

We therefore think it is preferable to apply exemptions ex-ante and to avoid appeals wherever possible. In order to have a robust penalty mechanism we consider "three lines of defence":

1.   Any infrastructure responsible for operating the penalty mechanism (i.e., CSDs, T2S) should build into their systems as much information as possible, and have robust controls in place in order to process the correct penalties.

2.   If there were any cases where an oversight of the automated mechanisms occurs and there is a mistake in the application of the penalty, there should be a filtering process operated by the CSD to review the output of the automated centralised mechanism and ensure that the information the participant receives is correct.

3.   Since there could be inaccuracies in the filtering process, the third line of defence would be the appeal process. However, as abovementioned, the core objective would be to have as few appeals as possible.

We recommend that the ECSDA Penalties Framework is revised in respect to the appeal process.<ESMA_QUESTION_SETD_7>

Q8   Do you agree with ESMA's proposal regarding the circumstances in which operations are not considered as trading? Please specify which cases you agree with and which cases you don't agree with (if applicable). Please justify your answer and provide examples and data where available.

<ESMA_QUESTION_SETD_8>

 In regards to which transaction types should be exempt from the penalty mechanism, we refer to the Annex document attached to this consultation, where we provide a more exhaustive breakdown of transaction type codes and differentiate between exemptions from cash penalties regime and a potential application of mandatory buy-ins.

With regards to the proposals presented in the consultation:

Free of Payment (FoP) securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral.

We believe that it would be beneficial for this scenario to be defined more precisely. Our understanding is that it is intended to refer to a specific process involving the European Central Bank and national central banks.

More generally, the movement of collateral between market participants is a risk management function for which it is important that settlement takes place on a timely basis. We do not see any reason why such transactions should be exempted from cash penalties, specifically. However, as noted in our response to Q1, we believe it is necessary to establish a separate scope of exemptions for MBIs, should they be reintroduced. Margin transfers should be explicitly removed from the scope of MBIs, on the basis that the receiving party has alternative means by which to manage the credit risk on a failed transaction (e.g., triggering a default notice, close-out netting, etc).

Market claims, corporate actions on stock such as cash distributions, securities distributions, reorganisations.

We are supportive of this proposed exemption.

In the event of a distribution, a pending transaction may effect that the holder on record date is not the entitled holder. In this case, a market claim may be created separately to the original transaction, to reallocate corporate entitlements. A market claim is an example of securities markets operations distinct from a transaction in a financial instrument. For this reason, it should not be subject to the penalties regime. The pending underlying transaction will be subject to a penalty where applicable.

In the vast majority of cases, market claims are automatically detected and generated by the CSD itself and therefore not the result of a transfer order initiated by the trading parties of the original transaction. A claim will be bilaterally agreed by the parties to the underlying transaction, in the event that it is not automatically generated by the CSD. This happens on an exceptional basis, and the settlement instructions are input by the settlement agent/sub-custodian rather than the trading parties of the original transaction. On this basis, we do not believe any distinction should be made on the scope of a market claim based on the means by which it was generated.

With respect to corporate actions on stock, we note that these instructions are already exempted from cash penalties as general practice under the ECSDA framework. We are therefore supportive of enshrining this in the regulation.

The process of technical creation of securities (i.e., the transfer from the CSD's issuance account to the issuer's CSD account).

We are supportive of this exemption.

Creation and redemption of fund units on the primary market (i.e., the technical creation and redemption of fund units, except for ETFs).

We are generally supportive of this exemption.

For ETFs in particular, we note the following considerations:

- The primary market transaction (i.e., the transfer between the transfer agent and the authorised participant) should be in scope of cash penalties.

- The mark-up/mark-down (i.e., the funds issued or redeemed on the fund issuance account of the transfer agent at the CSD/ depository) should be out of scope of the cash penalty mechanism as we understand this to be part of the process for the technical creation of securities.

Realignment operations

We note that, within the context of T2S realignment operations, these should specifically be left out of scope. <ESMA_QUESTION_SETD_8>

Q9   **ESMA would like to ask for the stakeholders' views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the circumstances in which operations are not considered as trading). 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's proposal - circumstances in which operations are not considered as trading		
	Qualitative description	**Quantitative description/ Data**
Benefits		
Compliance costs:		

- One-off - On-going		
Costs to other stakeholders		
Indirect costs		

<ESMA_QUESTION_SETD_9>

ESMA's proposal - circumstances in which operations are not considered as trading		
	Qualitative description	**Quantitative description/ Data**
Benefits	Efficiency: Avoids the generation and processing of cash penalties which will not incentivise improved settlement efficiency. Clarity: Provides greater certainty on the scope of application of cash penalties.	
Compliance costs: **- One-off** **- On-going**	Changes to systems: CSDs will need to make updates to penalty calculation mechanisms. These same changes will need to be replication by other market participants who are predicting/monitoring penalties.	
Costs to other stakeholders		
Indirect costs	Potential increase in appeals / manual processing: If all scenarios cannot be systemically excluded ex-ante from cash penalties calculations, there is likely to	

	be an increase in appeals to CSDs, creating additional work for all stakeholders.	

<ESMA_QUESTION_SETD_9>

Q10 **Do you have other suggestions regarding circumstances in which operations are not considered as trading? Please justify your answer and provide examples and data where available.**

<ESMA_QUESTION_SETD_10>

We are generally supportive of ESMA's targeted approach to identify specific circumstances in which operations are not considered as trading, for the purposes of exemption from cash penalties. AFME strongly cautions against the blanket exemption from cash penalties for any instruction which could be deemed as relating to an operation not considered as trading (for example, securities lending transactions.) Furthermore, there are transactions that, despite not being considered trading per se, generate synergies that are essential to the settlement of the trade itself.

Setting the scope of exemptions from cash penalties too broadly is likely to have a negative overall impact on settlement efficiency levels, to increase the complexity of the cash penalties mechanism, and to undermine the immunisation principle by creating scenarios whereby only certain transactions in a chain are in-scope.

We note that, as previously stated in our [response](#) to the European Commission's consultation on CSDR Refit, penalties and mandatory buy-ins are not comparable, the former applying to settlement whereas the latter relates to trading. This distinction has been understood by the legislators since in the delegated regulation 2018/1229 penalties apply to CSD's participants, while trading parties are the ones subject to mandatory buy-in requirements.

CSDR Refit even goes a step further by dedicating an article to each of these two components of the Settlement Discipline Regime but not far enough to have them treated fully separately. Indeed, they share the same list of exemptions mentioned in article 7(3)(a and b). If this does not represent an issue for the first one ("not attributable to …"), the fact that the second exemption ("operations that are not considered as trading") applies evenly to both penalties and mandatory buy-ins raises concerns: if there is no reason to exempt too many transactions from the scope of cash penalties, then there is a rationale to limit the scope of buy-ins to transactions that are real trades.

However, we propose to not consider share registrations which are instructed separately by the CSD participant as trading. Share registration instructions settle independent from the underlying settlement instructions. The registration process also differs from the settlement process

Instructions with No Change in Beneficial Ownership (NCBO)

For example: Portfolio Transfers (PORT), External Account Transfers (OWNE), Internal Account Transfers (OWNI) and Realignments (REAL).

Instructions that relate to transfers between accounts with no change in beneficial ownership clearly fall under ESMA's definition of operations not considered as trading activity. This is purely a technical administrative activity whereby the custodians change or there is a change in the custodians setup. Their inclusion on cash penalty reporting and calculations creates significant additional "noise" for market participants.

Generally, cash penalties would not necessarily incentivise settlement efficiency on such instructions, since it would be the same party sitting on both sides of the transaction.

However, if the instruction is part of a chain of linked transactions, an exemption could break the immunisation principle. In some cases, the settlement intermediary could be responsible for the failure of the instruction, rather than the beneficial owner, therefore it would be appropriate to penalise the responsible party in these circumstances.

We also note that market practices for using this transaction type code vary across different CSDs/markets, generating additional complexity. For example, the 'PORT' transaction code may be used incorrectly, which could result in invalid transactions being exempted, or lead to an increase in the number of bilateral disputes or claims, in cases where both parties do not input the correct transaction code on their instruction.

We would like to refer to the Annex document attached to the response to this consultation, where we provide a more granular input on which transaction types should be considered in scope of cash penalties (and MBIs) provisions.

We note that not all transaction type codes are supported across all the CSDs. We recommend that CSDs should continue improving their systems so all transaction type codes can be supported, thus leading to a more automated processing of cash penalties and a reduction in bilateral claims. Industry participants should look to accurately specify the corresponding transaction type, in accordance with the requirements of article 5.3 of CSDR RTS.

<ESMA_QUESTION_SETD_10>

Q11   If you have answered yes to the previous question, 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.

Respondent's proposal (if applicable)		
	Qualitative description	**Quantitative description/ Data**
Benefits		
Compliance costs: **- One-off** **- On-going**		
Costs to other stakeholders		
Indirect costs		

<ESMA_QUESTION_SETD_11>

N/A

<ESMA_QUESTION_SETD_11>

Q12   Do any of the exemption proposed above breaks the immunization principle? Please provide arguments.

<ESMA_QUESTION_SETD_12>

As mentioned in our response to Q5, we note that as soon as exemptions are not evenly applied to all settlement instructions, there is a risk that the immunisation principle will be breached.<ESMA_QUESTION_SETD_12>

Q13 **Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which one can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs?**

Please provide details regarding the cost for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

<ESMA_QUESTION_SETD_13>

We note that the Transaction Type code might appear as the ideal candidate to identify transactions to be exempted. However, its use poses some complexities:

• The type of transaction is decided by the parties to the transaction and then passed on by both in their own custody chain; therefore any decision to change this field would have to go back to the trading level;

• Lack of harmonisation, where not all types of transaction are recognised and processed in a single way across the CSDs;

• Hypothetical considerations on making the type of transaction a matching criteria would be detrimental to settlement efficiency and would trigger several issues: additional T2S/CSDs/internal implementation costs, an increase of late matching and/or matching discrepancies leading to an increase on settlement fails. Thus, we would not be supportive of Transaction Type becoming a matching criteria. We understand that the exemptions will be able to be filtered out ex-ante depending on the CSD's ability to support the various ISO transaction codes. However, we note the lack of harmonisation criteria on the use of the various transaction types across the different markets, which poses risks if the field is going to be used as a filter to exclude transactions.

<ESMA_QUESTION_SETD_13>

Q14 **For exemptions that can be filtered out in advance, do you think that a CSD would prefer to implement this filter or not? Also considering the very large number of appeals they might have to deal with and also the costs it will entail.**

<ESMA_QUESTION_SETD_14>

As noted in our response to Q6, the appeals process is highly manual, inefficient and time-consuming for all parties. We therefore think it is preferable to apply exemptions ex-ante and to avoid appeals wherever possible. <ESMA_QUESTION_SETD_14>

Q15   Which transaction types based on the codes allowed by T2S (or potentially other codes such as ISO transaction codes) should be exempted from settlement discipline measures? Please provide the codes, their definition and arguments to justify the exemption.

<ESMA_QUESTION_SETD_15>

In regards to what would be the specific mechanism for determining whether a transaction is exempt, we note that if only one party sends an instruction specifying an exempt ISO transaction code, then it would be inappropriate for that transaction to be treated as exempt.

We recommend that the ISO transaction code is not used as matching field, so that two instructions with different ISO transaction codes can continue to match and settle. The exemption from the penalty mechanism should only be applied to those transactions for which both instructions have the same, exempt, ISO transaction code.

We reiterate that not all CSDs accept all ISO transaction codes, therefore it is not possible to adopt a 'blanket' approach.

We refer to our Annex document attached to this response, where we provide a granular breakdown on the scope of application of the Settlement Discipline Regime to various transaction types. <ESMA_QUESTION_SETD_15>