

## Guidance on Cash Penalties under CSDR Settlement Discipline

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### Overview

- CSDR Settlement Discipline Regime will be introduced on 1 February 2022. It is designed to increase settlement efficiency rates in EU markets.
- One component of the regime is the introduction of **cash penalties** to be applied to all failing matched transactions.
- These penalties will be calculated at the end of each business day where an instruction fails to settle, from the **intended settlement date (ISD)** until the actual settlement date. Penalties will also be applied to an instruction that is matched after its ISD.
- Penalties do not exclusively apply to delivering participants; receiving counterparties can also be subject to penalty charges.
- The calculation is applied by the CSD and reported to its participants on a daily basis. Penalties will be collected and redistributed on a monthly basis by the CSD.
- For settlement instructions where one of the participants is a CCP, the CCP will be responsible for collection and redistribution of the penalties.
- The CSD will not retain any penalty, although the CSD may charge an administration fee. Any penalties debited from at-fault participants will be credited to the corresponding counterparty.

### Types of Penalty

There are two types of penalty: **Late Matching Fail Penalties (LMFPs)** and **Settlement Fail Penalties (SEFPs)**

#### 1. LMFPs

- These penalties will apply to any instruction matched after the relevant cut-off on ISD. LMFPs will be applied on the business day that the instruction matches, and retroactively for each day it failed to settle, back to ISD.
- LMFPs will be charged to the participant who was last to enter or modify the settlement instruction.

#### 2. SEFPs

- Settlement Fail Penalties will apply to any matched settlement instruction which fails to settle. SEFPs will be applied from ISD or, in case of late matching, the business day that the instruction matches, and continue to apply for each day it fails to settle until the actual settlement date or the cancellation of the instruction.

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- SEFPs will be charged to the participant who is responsible for the fail – this can be due to an ‘on hold’ instruction, linked instructions on T2S, ‘lack of securities’ or ‘lack of cash’. The CSD will conduct the checks to determine fault in that order.
- Both participants may also be penalised with SEFP should they both impede the settlement (e.g. due to a lack of stock on one side and an instruction to hold on the other side).

Note that LMFPs and SEFPs can apply to the same settlement instruction – but not on the same business day. Note that an unmatched instruction cancelled before matching/settlement due date will not be charged.

## Scope

### 1. Instructions

- In order for a penalty to be applied, the instruction must be settling at an in-scope CSD (i.e. it is listed on ESMA’s CSD Register).
- This means that internalised settlement instructions will not be in scope for cash penalties, unless the Settlement Internaliser (SI) chooses to independently calculate and apply penalties.
- AFME recommends that settlement agents or custodians inform clients of any settlement instruction which was internalised and not sent to the CSD, and would therefore not be in scope of cash penalties. This can be achieved using the INTS indicator under the STCO qualifier on relevant SWIFT messages.
- In case of cross-CSD settlement, where the “actual place of settlement” is a third-country-based CSD outside the scope of CSDR, no cash penalties will be applied.
- All types of transaction are in scope, although there are exceptional situations where the cash penalty mechanism should not apply:
  - a. Corporate actions on stock (identified by ISO code “CORP”)
  - b. 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
  - c. Technical impossibilities at the CSD level that prevent settlement, such as: a failure of the infrastructure components, a cyber-attack, network problems, etc.
  - d. In case of ISIN suspension from settlement due to a reconciliation issue under Article 65 (2) and (6) of the RTS on CSD Requirements
  - e. In case of ISIN suspension from trading

### 2. Instruments

- In order for a CSD to determine eligibility of a particular ISIN, we expect them to conduct the following checks:
  - a. Determine MiFID/MiFIR eligibility according to the FIRDS database
  - b. Identify if the ISIN is eligible for settlement in the CSD
  - c. Remove ISINs of shares where the primary trading location is a third-country<sup>1</sup>

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<sup>1</sup> CSDR Art. 7.13 states that CSDR Article 7 shall not apply where the principal venue for the trading of shares is located in a third country.

- All instruments which meet the above criteria will be in-scope for CSDR penalties

## Daily Process

- On a daily basis, the CSD will calculate and apply penalties for trades that failed to settle on the previous business day.
- CSDs need to source (or derive) and apply a reference price for each day when the settlement instructions fail to settle. Since this data is usually sourced from data vendors, the reference price will never be part of the daily/monthly CSD's reporting.
- The penalty rate applied will be determined by the type of instrument (please refer to next section.)
- The calculation, collection and payment of cash penalties is the responsibility of Central Securities Depositories (CSDs).
- Previously calculated penalties may be adjusted, should any static data (e.g. price) be revised. In limited circumstances, penalties may also be removed by the CSD.
- For non-EUR currencies, the relevant Central Banks' Foreign exchange (FX) rates shall be consulted. In an intra-CSD context, no FX issues should occur. The currency to be used for the penalties is at the discretion of the Calculating-CSD.
- All information on new, updated or removed penalties will be included in CSD's daily reporting to participants. Depending on the CSD, new and modified penalties may be included within the same reporting or in separate ones.

## Penalty Rates

Different penalty rates will apply depending on the type of instrument that fails to settle.

<i>Instrument Type</i>	<i>Daily Penalty Rate</i>
<b>Liquid Shares</b>	1.0 basis points
<b>Non-liquid Shares</b>	0.5 basis points
<b>Shares traded on SME-Growth Market venue*</b>	0.25 basis points
<b>SSA Bonds</b>	0.1 basis points
<b>Other Bonds</b>	0.2 basis points
<b>Bonds traded on SME-Growth Market venue*</b>	0.15 basis points

This exemption refers to one included in the Short Selling Regulation (SSR). For the purpose of SSR, ESMA has been required to maintain the list of the shares of a company admitted to trading on a trading venue in the EU where the principal venue for the trading of the shares is located in a third country. CSDs will use this list in order to exclude shares from the SDR scope. The list is publicly available on ESMA website: <https://www.esma.europa.eu/databases-library/registers-and-data>

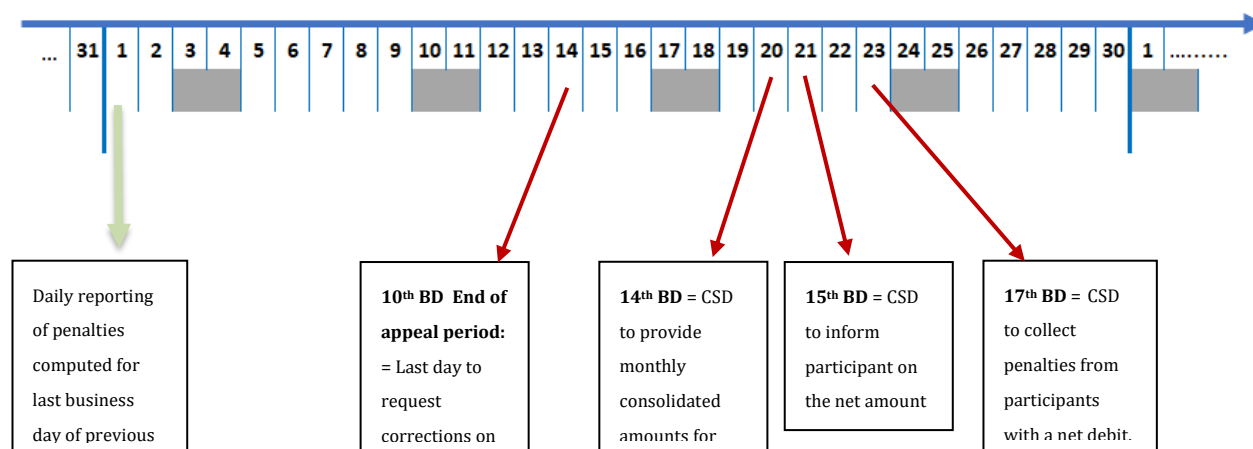
<b>All other instruments</b>	0.5 basis points
<b>Fail due to lack of cash</b>	<i>Official overnight interest rate of the currency issuer</i>

\*In order for this rate to be applied by the CSD, both participants must populate the SME-GM venue in the place of trading field on the settlement instruction. It is important to note that only transactions actually executed on the SME-GM venue are eligible for this reduced rate.

## Monthly Timeline

Penalties will be calculated and reported by the CSD on a daily basis. The collection and redistribution process takes place the following month, according to the below timeline:

<b>10<sup>th</sup> Business Day</b>	Deadline for participants to appeal any penalties received in the previous month.
<b>14<sup>th</sup> Business Day</b>	CSD to provide consolidated list of previous month's penalties.
<b>15<sup>th</sup> Business Day</b>	CSD to inform participant on the net amount to be debited or credited.
<b>17<sup>th</sup> Business Day</b>	CSD to collect penalties from participants with a net debit, and redistribute to parties with a net credit.



Note: These deadlines are imposed by the CSD for their direct participants. Other intermediaries may apply different deadlines for their clients, in order to ensure the CSD calendar can be adhered to.

## "Business Day" Definition:

- Most European CSDs have agreed on harmonisation for the process of the definition and counting of "business days" for the CSDR penalties management.
- Those specific "business days" are called "Penalties Business Days" (PBD). PBDs may differ from the actual "business days" of a CSD's settlement system or of a relevant payment system's calendar.

- Further guidance regarding CSD's business days can be found in the ECSDA Penalties Framework.

### *Appeal process:*

- There are specific circumstances in which a participant may appeal a penalty to the CSD, listed below:
  - ISIN suspension from trading or settlement (e.g. due to 'undue creation or deletion of securities' reconciliation issues);
  - 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, such as a failure of the infrastructure components, a cyber-attack, network problems, etc.
- AFME envisages that there will be other circumstances in which a penalty might be charged to a participant who is not responsible for the settlement fail, and therefore there may be a requirement for participants to bilaterally agree a cash payment to reimburse this penalty. Accordingly, AFME has published a document setting out market practice for "bilateral claims".

## FAQs

### *If the mandatory buy-in requirement is not enforced, will penalties continue to apply indefinitely?*

Yes. Cash penalties are applicable until the point at which the settlement instruction is settled or cancelled. The mandatory buy-in requirement provided a definitive end-date by when the settlement instruction must be settled or cancelled. If the mandatory buy-in requirement is disapplied, this means that cash penalties will continue to be accrued indefinitely.

### *What happens for instructions relating to a CCP-cleared transaction?*

According to Article 19 of the CSDR RTS on Settlement Discipline, where the failing or receiving participant is a CCP, the CSD shall continue to be responsible for calculating and reporting applicable penalties, but the CCP is responsible for the actual collection and redistribution of such penalties.

AFME, EACH, and ECSDA have all advocated that this exception be removed in order to create a simplified process.

### *What currency are penalties collected and redistributed in?*

AFME members' expectation is that the default should be that penalties are credited and debited in the currency of the settlement instruction (or the currency of the instrument in cases of FOP instructions).

### *Will CSD participants pass back penalties to their clients?*

The spirit of the regulation is to incentivise timely settlement by penalising the party at fault for the failure of the transaction. AFME's expectation, therefore, is that, generally, participants such as custodians and settlement agents will pass back penalties through the chain to the trading parties.

Where the custodian or settlement agent is responsible for the settlement fail, AFME recommends that the penalty is not passed back.

***How will clients know that credits or debits relate to CSDR penalties?***

AFME recommends that monetary amounts credited or debited in relation to cash penalties are appropriately tagged so as to be identifiable.

## Useful Links

- [Central Securities Depository Regulation](#)
- [CSDR RTS on Settlement Discipline](#)
- [CSDR Delegated Act on Cash Penalties](#)
- [ESMA Q&A on CSDR](#)
- [ECSDA Penalties Framework](#)
- [AFME Guidelines for Bilateral Penalties Claims](#)
- [ESMA CSD Register](#)
- [FIRDS Database](#)

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