9 July 2024
ESMA74-2119945925-2037

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	Clearstream Banking S.A.
Activity	CSD
Are you representing an association?	☐
Country / Region	Luxembourg

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>

In general, ESMA should kindly consider and clarify that any scope adjustments are valid for both, SDR penalties/ buy-ins as well as settlement efficiency rates calculations and fails reporting to keep consistency across the different aspects covered by SDR.

Also, sufficient lead time must be granted to all stakeholders for their IT to implement and enact any system changes.

Additionally, we see the proposal's aim as to ensure that participants are not unfairly penalised for settlement fails caused by external factors such as technical issues, market disruptions, regulatory changes and 'force majeure'.

Considering the current practice applied by Clearstream in line with the "ECSDA Penalties Framework", we generally support ESMA's proposal to focus on transactions and data that is truly relevant regarding settlement and financial risk aspects and specify settlement fails that are considered as "not attributable to the participants in the transactions" in cases of:

a) ISIN suspension from settlement due to a reconciliation issue under Article 65 (2) and (6) of the RTS on CSD Requirements;
c) 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;

d) technical impossibilities at the CSD level that prevent settlement, such as: a failure of the infrastructure components, a cyber-attack, network problems, technical (IT) issues in the system of the CSD.
i. settlement instructions involving securities under sanctions or anti-money laundering proceedings
ii. settlement instructions put on hold due to the order issued by a court, the police or similar authority with relevant mandate.

We, however, **disagree** with the point b) "*ISIN suspension from trading, such as for example under Article 32(1), Article 52(1), Article 69(2) of MiFID II or Article 40(1) of MiFIR*" **unless the approach to be taken is acknowledged by ESMA, i.e. CSDs will continue to rely solely on the ISINs listed in the ESMA FIRDS database to identify those ISINs in scope of the SDR.** Should suspended ISINs be out of SDR scope, **it must be ensured by all relevant Trading Venues** that such ISINs listed in FIRDS are labelled as "invalid" or no longer appear at all.

Background:

- It is impossible for CSDs to gather information for the whole universe of instruments eligible for settlement in a CSD from the numerous international trading venues;
- As a result, the principle of proportionality would not be obeyed as such exemptions would go far beyond what is necessary to achieve the objective of the Regulation that should be simple and limit to the largest extent possible financial, administrative, or procedural burdens for counterparties and financial infrastructure providers, in particular CSDs; it would also go against the objective of a cost-effective operation of post-trade infrastructures.
- Finally, trading suspension is irrelevant for the settlement eligibility of an ISIN on CSD or CSD participant level (and even further down the settlement chain as far as we can judge).

Hence, unless suspended ISINs listed in FIRDS are labelled as "invalid" or no longer appear at all, it would be practically impossible and unreasonable for CSDs and T2S to consider trading suspension as not attributable to the participants in case of settlement fails. As result, penalties would continue to be applied, and no appeals be accepted by CSDs (same as is the case already today and as stated in the ECSDA Penalties Framework).

With regard to the ESMA CSDR Q&A "H*ow should Article 7(12) of CSDR apply in respect of cash penalties due to, and owed by, a participant against which insolvency proceedings are opened*?" further clarification would be appreciated how to handle penalties that are due to be credited (not debited) to an insolvent CSD participant and if the Q&A shall be applied as well in cases of "reorganization proceedings" like liquidations or withdrawal of the banking license and covers the retroactive effect of suspension of payments resulting from the insolvency judgement. For background, please refer to the Banque Havilland case from August 2024.
<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>

For all points except b (trading suspension), we consider no relevant cost/ benefits as they represent current market practice.

For point b, as it is unfeasible for CSDs unless the relevant ISIN is removed from the ESMA FIRDS database, no cost can be estimated.

For the T2S penalty mechanism, please refer to the response of the ECB.
<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>

First, answering generically, considering many responses received in the context of settlement efficiency/ fails assessment: CSD participants mostly act on behalf of their underlying clients, the participants are actually dependent on the discipline/ behaviour or (complexity of) business scope (e.g. market making/ brokers; ETFs issuance) of their underlying clients to be able to match and settle transactions on time – whether such dependency leading to settlement fails should actually mean that a fail "*is not attributable to the participants*" cannot be judged by CSDs.

However, it would even be impossible for CSDs to identify such fail reasons and the consideration of such "global" aspects would probably lead to hardly applying any fails penalties at all in the future.

Hence, in addition to our response to Q1, we believe there are only very few specific other cases when the cause of a settlement fail may not be attributable to the participants:

1. Instructions cancellation by participants
   A borderline case could be transactions that are only unilaterally cancelled, e.g. when one participant acknowledges the transaction as being invalid, however, their counterparty (likely the penalties beneficiary/ "non-failing" participant) disagrees or takes no action for reasons unknown to the CSD. As a result, transactions may remain failing for longer periods with no ability for the participant that has cancelled its instruction to force the counterparty to bilaterally confirm the cancellation.

   It could therefore be debated if even **unilaterally** cancelled instructions should be exempted from the SDR scope from the point in time that a single cancellation request was received by the CSD.

2. Use of settlement instruction type "PFOD"
   Some CSD processes make use of PFOD (Payment Free of Delivery) settlement, e.g. to credit tax refunds, interest payments or securities cash redemptions to the participants.

   In such cases, the PFOD instructions are generated by the CSD vs. the participant's account. In some instances, an Intended Settlement Date (ISD) in the past (e.g. the value date of the tax refund payment received by the CSD) is applied to the PFOD that leads to the application of late matching penalties.

   It can be reasonably argued that at least PFODs generated by CSDs for their own processing towards participants should generally be exempted from the SDR application.

Preferably, any PFODs should be systematically excluded as they are not always offered for use by the participants (as it is the case for Clearstream) and represent very small transaction volumes in a CSD in any case.

3. Bridge settlement instructions de-selection by ICSDs
Delivery instructions may fail as they are either:

- not accepted by the receiving ICSD (CBL or Euroclear Bank (EB)) due to the lack of acceptance capacity (no unsecured exposure is authorised); or
- not proposed for settlement to the receiving ICSD due to the lack of Qualified Liquid Resources (QLR).

As those fails cannot be attributed to the participants, already today, penalties are not applied by Clearstream and Euroclear Bank for de-selection cases.

<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>

For all points referred to in Q3, we believe no major cost would be incurred by recalibrating the penalty mechanism or fails reporting scope definitions.

Benefits (for participants) are low overall but could be relevant for single participants (e.g. those few ones frequently appearing in the SDR "Top 10 failing participants" reports because of counterparties not matching their unilateral cancellation requests).
<ESMA_QUESTION_SETD_4>

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

<ESMA_QUESTION_SETD_5>

Not as far as we can judge.

<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>

For the Clearstream penalty mechanism, ex-ante exemptions can be applied for all items listed in Q1 and Q3 except "technical impossibilities at the CSD level" and "trading suspension" (unless relevant ISINs are removed from the ESMA FIRDS database).

The above-mentioned instances are already managed by CSDs and a process is in place as per ESMA Q&As, therefore we do not see the benefits of changing the ways these scenarios are handled by the CSDs.

For the T2S penalty mechanism, please refer to the response of the ECB.
<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>

A cost-benefit analysis should be carried out by CSDs in order to assess the impact of any change to be implemented.

We consider anyway that the ex-ante exemption must be the rule where possible to avoid manual intervention needs across all stakeholders.

"Appeals" are and must remain restricted to rare exception handling.
<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>

If any exemption is possibly implemented, it should be thoroughly assessed to avoid creating complexities and increasing risks.

Besides, we would like to share the following considerations:

- From an operational perspective, the primary consideration is whether the type of operation proposed to be exempted: (i) can be identified unequivocally, and (ii) can be filtered ex-ante by the penalty mechanism (i.e. built into the design), in order to be operationally manageable given the potential volumes of instructions to exempt and to avoid any manual interventions.
- Each settlement instruction must be filled in with a securities transaction type code also called ISO transaction code, to identify the type of transaction/ operation it belongs to. However, this field in the settlement instruction is not a matching criterion and the usage of transaction type codes may be restricted. In any case it is necessary that **both** settlement instructions of the receiving and delivering participant contain the relevant qualifier for CSDs to be able to apply the exemption.

Considering the above:

a. free-of-payment (FoP) securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral;

Firstly, we would like to reiterate the importance of ensuring that **both** the receiving and delivering participants' settlement instructions include the appropriate qualifier for CSDs to apply an exemption. However, we are seeking further clarity on the background and specific

rationale for this exclusion. It should also be noted that the fail rates on collateral transactions, as reported by Clearstream to ESMA on a monthly basis, are consistently very low.

b. market claims, corporate actions on stock, such as cash distributions (e.g. cash dividend, interest payment), securities distributions (e.g. stock dividend; bonus issue), re-organisations (e.g. conversion, stock split, redemption, tender offer).

We consider an exemption as being justified because:

- Market claims/ transformations are usually generated by CSDs so participants cannot directly influence the derived instructions' generation;
- The application of penalties on market claims/ transformations leads to applying the penalty to a single failing transaction twice (i.e. the initial failing transaction and its corresponding market claim transaction);
- Specifically e.g. for the German market, the current market claims generation process in line with German law may be systematically leading to late matching penalties (LMFPs).
- If a potential move to T+1 settlement would result in a material increase in the level of settlement fails – i.e. increases the number of unsettled transactions over record date – the consequence of this would also be an increase in the number of market claims and subsequently LMFPs.
- "Corporate actions on stock" are actually already today excluded from SDR penalties application as per T2S penalty mechanism design and "ECSDA Penalties Framework".

c. the process of technical creation of securities, meaning the transfer from the CSD's issuance account to the issuer's CSD account;

The potential criteria for CSDs and T2S to be able to clearly identify such transactions are yet to be assessed by all stakeholders.

We, however, agree that a failed delivery on a market sale transaction caused by the delay in issuing the instrument on the primary market or restrictions during a corporate action should not be excluded from the application of both cash penalties and the mandatory buy-in regime.

On the other hand, the transfer from the CSD's issuance account to the issuer's CSD account should not be considered a trading activity. It is a settlement technicality that involves no buying and selling. This distinction is key for operational efficiency.

d. creation and redemption of fund units on the primary market, meaning the technical creation and redemption of fund units (except for ETFs).

We agree to exclude subscriptions/ redemptions orders as well as “switch orders” that also do not represent trading activity. Hence, the exempted transactions scope – and including ETFs - should cover subscriptions/ redemptions/ switches.

For subscriptions/ redemptions/ switches, we consider an exemption as being justified because:

- Primary market processes: Such Investment Funds orders are not standard 'trades' of an instrument between two market participants but primary market processes of share creation or redemption between a specialised broker and the (ETF) issuer's agent, i.e. they do not involve two trading parties (but transfer agents for the fund business). Additionally, this primary market process can be prone to unexpected delay due to challenges of arranging delivery of a complex set of underlying assets. Improving this process is a highly technical undertaking and merely applying penalty fees is not an effective solution – in fact, financial penalties can reduce the efficiency of the product (ETF) by adding extra costs (penalty fees) that must be factored into the product's profile in the form of wider spreads, a cost which is ultimately borne by the end investors in the market;
- Investor protection: The primary goal of investment funds is to serve their investors' interests. Strict settlement discipline, if applied to creation and redemption orders, might lead to unintended consequences like forced asset sales, which could harm the fund's performance and, by extension, the investors' interests;
- Market stability: Large-scale redemptions, especially during market stress, can lead to forced selling of assets, potentially destabilizing markets further. Allowing some leeway in the settlement of these transactions can help mitigate such forced sales, providing fund managers with more strategies to manage redemptions in a way that minimizes market impact;
- Liquidity management: Open-ended funds need to manage liquidity to meet redemption requests without significantly impacting the fund’s performance or the remaining investors. Excluding these transactions from strict settlement disciplines allows funds more flexibility to manage their liquidity, especially during times of high redemption pressure;
- Operational flexibility: The creation/ redemption orders process involves several operational steps, including the calculation of the Net Asset Value (NAV), which can only be done after the market close. This process might not align neatly with standard settlement cycles. Exclusion from the settlement discipline regime allows for the necessary operational flexibility to manage these unique processes efficiently. “Switch orders” involve transferring investments between different funds within the same fund family. Excluding them helps avoid disrupting the settlement process for these specific transactions, contributing to smoother operations and minimizing potential market impact associated with such internal transfers within investment funds.

e. realignment operations.

We assume this refers only to T2S technical realignments – if so, we agree to the exemption proposal.
<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>

Considering our response to Q15, as long as both settlement instructions of the receiving and delivering participant contain the relevant qualifier for CSDs to be able to apply exemption, implementation cost for CSDs are considered to be low.

For the T2S penalty mechanism, please refer to the response of the ECB.
<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>

In line with our participants, we believe that the CSDR scope is currently too wide as it goes beyond the settlement of trading activity and covers as well participants' "internal" and other specific transactions.

Hence, we strongly recommend reducing the scope of transactions subject to SDR for ESMA to focus actions on data that is truly relevant regarding settlement and financial risk aspects and exclude the "*operations that are not considered as trading*" listed below from SDR consideration in future.

It should be noted that such fails do not negatively impact another participant's trading activity.

1. Share registration bookings (specifically relevant for CBF/ German market where regularly failed DE registered shares ("CASCADE RS") "high value" free of payment share registration orders occur that negatively impact the settlement efficiency rates of individual participants and being the main reason why they occur as "Top 10 failing" participants" in CBF's monthly SDR fails reporting to ESMA.
2. Portfolio transfers;
3. Transfers between (main or sub-)accounts of the same participant, assuming there is normally no change of beneficial ownership involved.

For these processes, as the same participant (or underlying client) is actually the payer and receiver of the respective SDR penalties, such penalties have no financial or incentivising effects.

As result, we request ESMA to ensure that in future such transactions should neither be made subject to penalties and mandatory buy-ins nor be considered in the SDR settlement efficiency rates calculation of CSDs.

In order to exclude (ex-ante or ex-post) such transactions, CSDs need to be able to clearly identify them, e.g. based on dedicated SWIFT qualifiers in the relevant settlement instructions.
<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>

Considering our response to Q15, as long as both settlement instructions of the receiving and delivering participant contain the relevant transaction qualifier for CSDs to be able to apply exemption, implementation cost for CSDs are considered to be low.

<ESMA_QUESTION_SETD_11>

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

<ESMA_QUESTION_SETD_12>

No, the exemptions above give a more granular view but they do not break the immunisation principle.

<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>

For the Clearstream penalty mechanism, assuming that both settlement instructions of the receiving and delivering participant contain the relevant qualifier and leaving aside the items:

a. free-of-payment (FoP) securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral;

c. the process of technical creation of securities, meaning the transfer from the CSD's issuance account to the issuer's CSD account;

ex-ante exemption can be applied for all items listed in Q8 and Q10.

For the T2S penalty mechanism, please refer to the response of the ECB.

<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>

Ex-ante exemption must be the rule to avoid manual intervention needs across all stakeholders.

"Appeals" are and must remain restricted to rare exception handling.

<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>

Considering our response to Q8 and Q10, **for CSDs or T2S to be able to** systematically exempt transactions from SDR, both participants' settlement instructions must contain a dedicated (SWIFT) qualifier (below list to be confirmed by all stakeholders):

- "CLAI"/ "TRAN" for market claims/ transformations; "CORP" for corporate actions on stock;
- "REDM", "SUBS", "SWIF", "SWIT" for Investment Funds redemption/ subscription/ switch orders
- "OWNI"/ "OWNE" for DE share registrations (CASCADE RS);
- "PORT" for portfolio transfers;

Note: as per market current practice. corporate actions on stock and T2S technical realignments are already today not generating penalties.

<ESMA_QUESTION_SETD_15>