

BVI¹ response on the ESAMA`s Technical Advice on the CSDR Penalty Mechanism

We welcome the initiative by ESMA to assess with the market the effectiveness and proportionality of the current penalty mechanism and propose, if justified, changes to the structure or severity of the mechanism and consider alternative methods for calculating cash penalties, including by introducing progressive penalty rates.

- **Key considerations**

We support the aim to achieve an efficient, integrated and safe market for securities clearing and settlement in the EU, particularly for cross-border transactions. Efficient and safe securities settlement systems with an EU wide harmonized settlement discipline regime will benefit all investors and further promote a pan-European securities market.

Highly regulated investment funds (UCITS/AIF) and asset managers are part of the Buy-side of wholesale financial services. Buy-Side firms are users of the post trading market infrastructure rather than providers of post trade services (e.g. CCPs, CSDs). The investment fund market in Europe is rather fragmented in terms of trade and post-trade operational models. The value chain of fund investing (primary market; subscription/redemption) and secondary market trading of fund shares (ETFs), and settlement, custody and asset servicing usually works very efficiently in local markets in the EU and for most local funds.

German investment fund management companies are not directly involved in the value chain of clearing and settlement of securities transactions. They instruct the custodians of the investment funds to match and settle securities (e.g. equity, bonds, ETFs, fund units) belonging to such investment portfolios. The custodians have a direct access with the CSDs. Investment fund management companies have to rely on the information obtained by the custodians in order to react in cases of settlement fails or buy-ins. The custodians have to ensure that all relevant settlement information needs to be sent as fast as possible to the fund management companies. This will enable the investment fund management companies to solve all discrepancies for unsettled and failing trades where a decision is required by the custodians from the investment managers. A fast transformation of settlement information from the fund custodian to the asset manager is of utmost importance if the settlement cycle will be shortened to T+1/0.

(Institutional) investors defined as professional clients in MiFID are not involved in the clearing and settlement process of securities transactions. There is only direct relationship between the fund management company, the counterparty of the transaction (e.g. broker/dealer) and the fund custodian.

¹ BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 114 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.



Investment funds (may) delegate primary market and issuing functions to Transfer Agents (TA, transfer agent model) or Issuing Agents (IA). This function may also sit with the asset manager, a depositary bank or another specialised third party provider, usually a custodian bank. Markets where a dedicated service provider performs this function, the Transfer Agent (TA), are amongst others the UK and Ireland. In France and Germany this function is normally performed by the custodian, acting also as Issuing Agent for the shares in the national and cross-border CSD's.

Besides the actively managed investment funds there is an increasing number of funds which are listed on stock exchanges, which often track indices, and whose main form of trading occurs in the secondary market, the so-called Exchange Traded Funds (ETFs).

In the context of the recently concluded review of the CSDR, the agreement to maintain a mandatory buy-in as part of the settlement discipline regime should only be considered as a measure of last resort where the rate of settlement fails in the EU is not improving and may present a threat to financial stability. Therefore, it is of utmost importance that the cash penalty system is carefully calibrated to improve settlement efficiency within the EU. This indicates that cash penalties will play an even greater role in ensuring settlement discipline in the future. We believe that certain features of the Settlement Discipline regime can be utilized to drive greater settlement efficiency and improved operational processes, for the ultimate benefit of the end investor.

However, in order to make important updated regulatory decisions, such as imposing a more complex cash penalty system, regulators should act prudently and be guided by comprehensive and robust data assessments that include a review of the relevant settlement risks and impacts on financial stability and on the competitiveness of EU market participants (e.g. EU buy-side). According to our observation, such a comprehensive and robust data assessment on the settlement performance (including settlement fail rates and cash penalty regime) has not been produced within the EU. In Europe there is a clear lack of high-quality, granular, public data on settlement fail rates and reasons, which has proved a barrier to assessing the current environment. ESMA confirms this in their consultation paper (please see para 45, p. 26 and para 51, p. 27) that they do not have data on the breakdown of cash penalties (by number and value) applied by CSDs and by asset type.

There is currently no general methodology for calculating settlement rates, which leads to difference in figures produced by different sources. Publicly available data delivers only a very limited analysis on how settlement fails differ across various types of instrument, and on the average duration of settlement fails. EU-CSDs should be the "golden source of record" of settlement fails and responsible to deliver to ESMA and the national regulators accurate settlement data. The German buy-side has no (aggregate) data for settlement fails etc at hand.

Furthermore, Europe has principally lower settlement efficiency rates than other regions, although it is difficult to draw a direct comparison due to significant differences in market structure, processes and standards. For instance, the US market regime for trading, clearing and settlement is concentrated in significantly fewer financial market infrastructures as compared to the significant fragmented EU ecosystem. The higher proportion of cross border transactions creates additional complexity in Europe – for example, in trade matching, settlement and position management processes. US market participants can assume with a high degree of certainty that their transaction will be settled in only one CSD (DTC). In Europe, it is important that counterparties proactively communicate and agree the place of settlement, to reduce the likelihood of any mismatches.



The introduction of the CSDR cash penalty regime in February 2022 has not improved the settlement efficiency for the German Buy-Side. Asset managers have to rely on the accurate information obtained by the (fund) custodians in order to react in cases of settlement fails. The custodians have to ensure that all relevant settlement information needs to be send as fast as possible to the fund management companies. This will enable the investment fund management companies to solve all discrepancies for unsettled and failing trades where a decision is required by the custodians from the investment managers. According to our observations the main reasons for settlement fails are missing securities on the Sell-Side, instructions that are sent too late to the markets or problems with the settlement instructions (SSIs). The introduction of the CSDR cash penalty system has increased the operational burden for the Buy-Side as they have to monitor every penalty of a failed trade which belongs to an investment funds without any additional value for the settlement efficiency. Some German asset manager have increased their internal resource to handle and to monitor only the cash penalty process thereby, increasing their operational costs without any additional value for the settlement efficiency. Also, some asset managers today use more internal resources to cover the cash penalty process than for the daily settlement discrepancies.

In this context, we expect more settlement fails on a daily basis for trades, large or small, in the short-term with an EU move to T+1. However, at this stage, it is impossible to predict if the settlement fail rates will be higher over long period of time compared to the current settlement cycle in Europe.

We do not see any value to modify the current CSDR cash penalty system and disagree with ESMA`s proposal to consider alternative methods for calculating cash penalties, by introducing progressive penalty rates. We clearly expect more operational complexity and burden for the German buy side without any improvement for the settlement efficiency if progressive penalty rates are introduced as suggested within the consultation paper. Furthermore, progressive penalty rates could distort the market by reducing liquidity, for instance for fixed income products. This would impeded the smooth and orderly functioning of markets.

- **Specific comments**

We would like to make the following specific comments:

Q1: Do you agree with ESMA's proposal? Which Option is preferable in your view? Please also state the reasons for your answer.

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

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.

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.

We consider the impact for the German buy-side to apply a possible approach only to one country within the EU (Denmark) as manageable. Normally, German asset managers rely on the information



provided by the (fund) custodians in respect to the interest rate paid for cash within the regulated investment fund (UCITS/AIFs).

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).

Q6. What are the causes of late matching? How can you explain that there are so many late matching instructions lasting during a very long period? What measures could be envisaged in order to reduce the number of late matching instructions?

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.

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).

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.

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.

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

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.



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.

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.

We acknowledge the fact that late matching instructions are witnessed by the German Buy-Side in a relatively small proportion, for instance in the US market. Due to partial settlement, it may occur that a few securities transactions are pending for more than 90 days.

We agree with the proposal that issuer CSDs for each financial instrument shall be responsible and liable for confirming the relevant reference data to be used for the related penalty calculation due to late settlement instructions. CSDs have the relevant matching and settlement information in order to calculate the relevant reference data to be used for the related penalty calculation. Asset managers are not directly involved in the value chain of clearing and settlement of securities transactions. They instruct the custodians of the relevant investment funds to match and settle securities (e.g. equity, bonds, ETFs, fund units) belonging to such investment portfolios. The custodians have a direct access with the CSDs. Therefore, the Buy-Side do not have any data to make such a computation.

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.

The introduction of the CSDR cash penalty regime in February 2022 has clearly not improved the settlement efficiency for the German Buy-Side. Asset managers have to rely on the information/accuracy obtained from the (fund) custodians in order to react in cases of settlement fails. The custodians have to ensure that all relevant settlement information needs to be send as fast as possible to the fund management companies. This will enable the investment fund management companies to solve all discrepancies for unsettled and failing trades where a decision is required by the custodians from the investment managers.

According to our observations the main reasons for settlement fails are missing securities on the Sell-Side, instructions that are sent too late to the markets or problems with the settlement instructions (SSIs). The introduction of the CSDR cash penalty system has increased the operational burden for the Buy-Side as they have to monitor every penalty of a failed trade which belongs to an investment funds without any additional value for the settlement efficiency. They try principally to claim every (small) amount due to their fiduciary function. Therefore, some German asset manager have increased their internal resource to handle and to monitor the cash penalty process thereby, increasing their operational costs without any additional value for the settlement efficiency. Some asset managers use today more internal resources to cover the cash penalty processes than for the daily settlement discrepancies.



German investment fund management companies are not directly involved in the value chain of clearing and settlement of securities transactions. They instruct the custodians of the relevant investment funds to match and settle securities (e.g. equity, bonds, fund units, settled via CSDs) belonging to such investment portfolios. The custodians have a direct access with the CSDs. Therefore, investment fund management companies have clearly to rely on the settlement efficiency (including STP rates) and settlement resources provided by the relevant (fund) custodians in order to react in cases of settlement fails, mismatches etc, resulting in a high STP rate for investment funds. At this stage, we cannot provide any figures.

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.

Please see our answer to question Q15. We do not believe that the CSDR penalty mechanism discourage settlement fails and incentivise their rapid resolution. German asset managers have to rely on the settlement information provided by their (fund) custodians and their respective CSDs. We encourage the fund custodians to provide the relevant penalty information as fast as possible.

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.

Please see our answer to Q15. Within the fund industry, most settlement fails are generally caused by brokers/dealers and not by UCITS/AIFs as they are typically on the long only side. According to our observations, further main reasons for settlement fails are, instructions that are sent too late to the markets. However, our members have also witnessed problems with the accuracy of settlement instructions (SSIs).

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.

Market participants (e.g. Buy-Side) should try to use as practical as possible more automated and recognised market tools (e.g. centralised SSI data base provided by specialised vendors) to match securities transaction on trade day. However, such usage of recognised market tools should be updated by all relevant market participants on a regular basis (e.g. SSI data base). Due to the introduction of T+1 in the US at the end of May 2024, our members have already started to further automate and streamline their trading, matching and settlement processes in cooperation with their respected (fund) custodians on the basis of widely recognised market tools.

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.

We have no comments.

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.



Please see our answer to Q15.

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.

We strongly agree with ESMA's proposal that all EEA-CSDs should provide the relevant settlement data. There is currently no general methodology for calculating settlement rates, which leads to difference in figures produced by different sources. Publicly available data delivers only a very limited analysis on how settlement fails differ across various types of instruments, and on the average duration of settlement fails. EU-CSDs should be the "golden source of record" of settlement fails and responsible to deliver to ESMA and the national regulators accurate settlement data.

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.

We do not see any value to modify the current CSDR cash penalty system and disagree with ESMA's proposal to consider alternative methods for calculating cash penalties, by introducing progressive penalty rates. We clearly expect more operational complexity, costs and burden for the German Buy side without any improvement for the settlement efficiency if progressive penalty rates are introduced as suggested within the consultation paper. If progressive penalty rates would be introduced, it could be possible that such rates could be passed on within the value chain from the custodian over the asset manager to the final investor, who could ultimately pay the fee.

Furthermore, progressive penalty rates could distort the market by reducing liquidity, for instance for fixed income products. Broker/Dealers acting for instance as market maker/liquidity provider could factor in progressive penalty rates, thereby deteriorating the price offerings for the Buy-side. This would impede the smooth and orderly functioning of markets.

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

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.



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.

Please see our answer to Q22.

Q25: What are your views regarding the level of progressive penalty rates: a) as proposed under Option 1? b) as proposed under Option 2?

Please see our answer to Q22. We disagree with the introduction of progressive penalty rates.

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.

The introduction of the CSDR cash penalty regime in February 2022 has not improved the settlement efficiency for the German Buy-Side.

However, in order to make important updated regulatory decisions, such as imposing a more complex cash penalty system, regulators should act prudently and be guided by comprehensive and robust data assessments that include a review of the relevant settlement risks and impacts on financial stability and on the competitiveness of EU market participants (e.g. EU buy-side). According to our observation, such a comprehensive and robust data assessment on the settlement performance (including settlement fail rates and cash penalty regime) has not been produced within the EU. In Europe there is a clear lack of high-quality, granular, public data on settlement fail rates and reasons, which has proved a barrier to assessing the current settlement fail environment.

Therefore, we strongly encourage ESMA in cooperation with the national competent authorities to provide a comprehensive assessment on the settlement performance (including settlement fail rates and cash penalty regime) for the EU. Based on this analyse ESMA should start again the discussion with the market participants whether an amendment of the current settlement cash penalty system within the EU is really necessary.

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.

Please see our answer to Q22.

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.



Please see our answer to Q22. We do not see any value/benefit to modify the current CSDR cash penalty system and disagree with ESMA's proposal to consider alternative methods for calculating cash penalties, by introducing progressive penalty rates. We clearly expect more operational complexity, costs and burden for the German buy side without any improvement for the settlement efficiency if progressive penalty rates are introduced as suggested within the consultation paper.

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.

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.

Please see our answer to Q22. We do not believe that a more complex CSDR penalty rate regime will improve the settlement efficiency within the EU.

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. Additional considerations to simplify the cash penalty mechanism, while ensuring it is deterrent and proportionate.

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.

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.



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.

Please see our answer to Q22.

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.

Please see our answer to Q22.

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.

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.

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.

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).**

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.

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.

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).

We have no comments.

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.

Please see our answer to Q22.

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.

We have no data at hand. Such information could only be provided by the EU-CSDs and not by indirect market participants (e.g. asset managers).

Furthermore, Europe has principally lower settlement efficiency rates than other regions, although it is difficult to draw a direct comparison due to significant differences in market structure, processes and standards. For instance, the US market regime for trading, clearing and settlement is concentrated in significantly fewer financial market infrastructures as compared to the significant fragmented EU ecosystem. The higher proportion of cross border transactions creates additional complexity in Europe – for example, in trade matching, settlement and position management processes. US market participants can assume with a high degree of certainty that their transaction will be settled in only one CSD (DTC). In Europe, it is important that counterparties proactively communicate and agree the place of settlement, to reduce the likelihood of a any mismatches.

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.

The market practices provide a different picture. Some CSD participants (e.g. (fund) custodians) provide the relevant penalty information to their clients (e.g. asset managers). Asset Managers have to rely on the penalty information provided by the CSD participants as they have to monitor every penalty of a failed trade which belongs to an investment funds (UCITS/AIF). However, some CSD participants (e.g. (fund) custodians) do not pass the relevant information to their clients. Therefore, some German asset managers have a bilateral agreement that no penalties will be distributed to the investment fund.



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.

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.

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?

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.

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?

We have no comments.

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.

Yes, the settlement efficiency should 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. Indirect CSDs participants (e.g. Buy-Side) should also attend such User Committees in order to better understand settlement fail rates.