15 December 2023
ESMA74-2119945925-1704

Reply Form

to the Consultation Paper on Technical Advice on CSDR Penalty Mechanism

Responding to this Consultation Paper

ESMA invites comments on all matters in this Consultation Paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **29 February 2024.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

- Insert your responses to the questions in the Consultation Paper in this reply form.
- Please do not remove tags of the type < ESMA_QUESTION_CSDR_0>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
- When you have drafted your responses, save the reply form according to the following convention: ESMA_CP1_CSDR _nameofrespondent.

  For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA_CP1_CSDR _ABCD.
- Upload the Word reply form containing your responses to ESMA's website (**pdf documents will not be considered except for annexes**). All contributions should be submitted online at *www.esma.europa.eu* 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	Deutsche Boerse Group
Activity	Credit institutions, CSDs, investment firms, market operators, e-money institutions, UCITS management companies, AIFs
Are you representing an association?	☐
Country / Region	Germany

2 Questions

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

<ESMA_QUESTION_CSDR_1>

Executive summary:

Deutsche Börse Group, as a financial market infrastructure, responds from its perspective of a CCP (Eurex Clearing AG – ECAG) as well as from its CSDs' perspectives (Clearstream Banking AG – CBF, Clearstream Banking S.A. – CBL, and LuxCSD S.A.).

Clearstream main points:

- Clearstream does not see a need for initiating significant changes of the current penalties calculations approaches at this early stage and as none of the options proposed by ESMA will likely have a measurable impact on the settlement efficiency rates.

- However, we strongly recommend adjusting the scope of transactions subject to penalties and settlement fails reporting for ESMA to focus actions on data that is truly relevant regarding settlement and financial risk aspects (see Q16).

- Any action on penalties should also be evaluated in the context of the upcoming T+1. We expect that fails will remain/potentially increase in the shorter settlement cycle, irrespective of efforts of market participants, in particular for international investors. Penalties on top of the efforts towards T+1 can therefore undermine EU competitiveness.

- In line with our participants and obviously to be applied for all CSDs/markets, we strongly recommend to fully exclude e.g. market claims and transformations from the scope of penalties application as well as settlement fails reporting in future.

- If some CSDs have lower settlement fail rates than others, applying the penalty mechanism at individual CSD [or CSD SSS] level (based on the CSD settlement fail rates) would not be the right approach due to the interconnectedness of securities markets and among CSDs in the EEA.

- In Clearstream's view, the two penalties calculation options proposed by ESMA (see questions 26 to 31) would represent a significant change compared to the current penalties calculation approach. The cost/benefit ratio is too low to justify any change that will require relevant IT developments and would make the application of penalty rates much further complex for transactions failing for more than one day (including late matching fails).

- Should ESMA eventually believe that the current daily penalty rates are too low, the rates could be easily increased without making significant structural changes to the penalties mechanism.

- Clearstream is aligned and generally in agreement with the responses provided by the ECSDA and ECB/T2S responses.

ECAG main points:

- As a CCP, ECAG takes a neutral position on topics 3 'Alternative parameters, when the official interest rate for overnight credit charged by the central bank issuing the settlement currency is not available' and 4 'Treatment of historical reference data for the calculation of late matching fail penalties'. These topics are more relevant to the penalty processing of a CSD. ECAG as a CCP takes in general a neutral position on topic 5 'Alternative methods for calculating cash penalties, including progressive penalty rates'.

- ECAG welcomes activities that lead to higher settlement efficiencies at the CSDs. However, ECAG would like to make ESMA aware of the likely increase of systematic cash penalty imbalances from a CCP view if progressive penalty rates are applied in

the area of cleared CCP business (see also our answer to Q22, independent of both options, and Q30).

- For ECAG, progressive penalty rates based on failed value raises the risk for systematic imbalances for CCPs in both directions (loss and surplus from a CCP view).

Specifically regarding the suggested approaches on cash discount rates:

Clearstream: the actual occurrences of fails requiring the consideration of cash discount rates (i.e. fails due to "lack of cash" as well as receipts versus payments that are put "on hold") is very low; hence, **we doubt there is actually a need for changing the current approaches as none of the options proposed by ESMA will likely have a measurable impact on the settlement efficiency rates**. Instead, any options will incur development and/ or maintenance cost for CSDs, T2S and other stakeholders without benefits.

➔ **Therefore, Clearstream does not recommend making any changes.**

Especially Option 1 represents a **totally new approach** that would lead to **multiple IT developments**, i.e. cause much more efforts/ cost than Options 2, 3 and 4 as it would **introduce a double currency conversion process** (i.e. initial currency to be converted to EUR and back after penalty calculation) which requires a completely new IT development (including in T2S) with too high cost for a very small business scenario and almost no benefit.

Should ESMA nevertheless chose Options 1, 2 or 3, we urgently request that the **actual cash interest rates** to be applied by CSDs for their da**ily penalty calculations would be already calculated by the Central Banks or ESMA and centrally published and maintained up to date by e.g. ESMA for all stakeholders**. This ensures an efficient process for the same reference data being available to all stakeholder, avoids individual manual penalty rate calculation needs and the subsequent risk of potential errors (e.g. due to "*day count conventions and other adjustments*") when calculating the applicable rates by every single stakeholder.

It should be noted that **Options 1 to 3 miss to address similar issues that exist for "lack of cash" fails in non-EU currencies** (e.g. USD or JPY; see ECSDA Penalties Framework for details about the current approaches applied). As stated by ESMA, the ECSDA Penalties Framework includes rules to define the cash discount rates – for all three options, these rules must be reviewed.

Despite technical development needs – **if any changes would finally be decided by ESMA** - Clearstream´s preference is **Option 4 but without applying progressive rates**. The rationale is that the **rates definition and maintenance process would be much simpler and transparent**, avoid the need to search, calculate or source, monitor and update the applicable

rates for any currency on a frequent basis and be comparable with the existing approach applied for “lack of securities” fails.

We cannot judge the proportionality of the daily rates as proposed by ESMA in Option 4, however, **they appear very high on an annualized basis** (especially due to the progressive approach that should be avoided also from a technical perspective) and **we are highly concerned that the competitiveness of the EU capital markets could be negatively impacted by the application of overly high (even extreme) daily penalty rates overall**.

Further, we would like ESMA to consider that any proposal/ option needs to be carefully evaluated in the context of the expected shortening of the settlement cycle to “T+1” as we expect that fails will increase, irrespective of efforts of market participants, and in particular for international investors. Increasing penalties on top of implementing T+1 can therefore undermine EU competitiveness. I.e. making the penalties regime more restrictive and implementing shortening of settlement cycle in parallel is antithetic as implementation of T+1 will probably require at least a period of tolerance.

<ESMA_QUESTION_CSDR_1>

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

<ESMA_QUESTION_CSDR_2>

Clearstream:

- ⇨ **We see no need for changes, please see our response to Question 1.**

ECAG:

- ⇨ **Progressive penalty rates could lead to systematic imbalances in the view of CCPs and might not be applicable to the cleared business of CCPs.**

<ESMA_QUESTION_CSDR_2>

Q3 Do you agree with the approach followed for the Option you support to incorporate proportionality in the Technical Advice? If not, please provide an indication of further proportionality considerations, detailed justifications and alternative wording as needed.

<ESMA_QUESTION_CSDR_3>

Clearstream:

Please see our response to Question 1.

<ESMA_QUESTION_CSDR_3>

Q4 What costs and benefits do you envisage related to the implementation of each Option? Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA_QUESTION_CSDR_4>

Option		
	Qualitative description	**Quantitative description/ Data**
Benefits	Options 1-3: none Option 4: saves rates data sourcing/ monitoring/ update processing needs.	Options 1-3: n/a Option 4: low, operational staff savings; potentially slightly lower reference data supplier fees.
Compliance costs: **- One-off** **- On-going**	Option 1: one-off: IT development/ on-going: operational and reference data supplier fees. Options 2, 3: one-off: none/ on-going: operational and reference data supplier fees. Option 4: one-off: IT development/ on-going: none.	Option 1: one-off: IT (high)/ on-going: low, FTE and ref. data supplier fees. Options 2, 3: one-off: none/ on-going: low, FTE + ref. data supplier fees. Option 4: one-off: IT, medium/ on-going: none.

Costs to other stakeholders	All options: adaptation of current calculation rules. Options 1-3: Central Banks, ESMA to centrally provide the concrete applicable penalty rates for all stakeholders	All options: unknown
Indirect costs	All options: unknown	All options: unknown

Concrete efforts/ costs cannot be precisely estimated at this stage but are expected to be high for Option 1 (requiring currency conversion), low for Options 2, 3 and medium for Option 4.

<ESMA_QUESTION_CSDR_4>

Q5 As a CSD, do you face the issue of accumulation of reference data related to Late Matching Fail Penalties (LMFPs), that may degrade the functioning of the securities settlement system you operate? If yes, please provide details, including data where available, in particular regarding the number and value of late matching instructions, as well as for how many business days they go in the past from the moment they are entered into the securities settlement system, and the percentage they represent compared to the overall number and value of settlement fails on a monthly basis (please use as a reference the period June 2022 – June 2023).

<ESMA_QUESTION_CSDR_5>

Clearstream:

The accumulation of reference data related to Late Matching Fail Penalties (LMFPs) does not degrade the functioning of the relevant systems Clearstream operates; Clearstream calculates the LMFP for the whole period from ISD to match date (note: instructions with ISD > 400 calendar days in the past are not accepted by CBL). For every penalty calculated by CBL, the penalty and reference data used is archived for a minimum of 10 years after 3 months.

Nevertheless, we acknowledge and **fully support** the demand of T2S penalty mechanism **to limit the reference data history used by the T2S mechanism**. Such limitation should, however, be optional for the application by CSDs/ platforms other than T2S.

It is important to clarify that ESMA´s current or any future proposal must not lead to the need for CSDs and T2S to re-calculate penalties on a daily basis when the (40/ 92 or any other) period was exceeded for a previously already calculated and still amendable penalty.

<ESMA_QUESTION_CSDR_5>

Q6 What are the causes of late matching? How can you explain that there are so many late matching instructions? What measures could be envisaged in order to reduce the number of late matching instructions?

<ESMA_QUESTION_CSDR_6>

Clearstream:

The main cause for late matching is that instructions are sent by the participants only after their intended settlement date (ISD).

As far as we can judge and derive from our clients´ feedback, the main reasons for late matchings are related the trading level (transaction mis-matches which are only rectified after the intended settlement day, e.g. due to price mismatches, discrepancies on the number of securities) as well as incorrect settlement instructions which require a late amendment to allow matching. In some cases settlement instructions for portfolio transfers are not sent in time or in the required format or contain different ISDs.

However, opposite to ESMA´s statement, our data does not indicate that there are “so many” late matching instructions. For example, in 2023, 94% of the CBF transactions that settled after the intended settlement did not represent late matchings.

In our view, the tools (like “hold and release”) are already available to participants to send settlement instructions to CSDs before the ISD even when no sufficient cash/ securities are available on ISD to avoid late matching. The extended use of this tool could reduce the occurrence of late matchings unless the reasons for late instructions are outside the control of the CSD participants (e.g. issues/ delays occur on trading level).

For the DE market/CBF for example, due to legal reasons, the market claims settlement instructions generation by CBF takes place systematically only when the underlying

transaction actually settled – i.e. when settlement occurred after ISD, late matching penalties automatically apply to the market claims.

In line with our participants and obviously to be applied for all CSDs/markets, we strongly recommend to fully exclude market claims and transformations from the scope of penalties application as well as settlement fails reporting in future as:

- in any case, market claims/ transformations settlement transactions do not represent trading activity;
- participants cannot directly influence the instructions generation;
- the application of penalties on market claims/ transformations leads to a kind of "double-penalization" of a single failing transaction;
- the current German market claims generation process cannot be changed due to legal reasons.

Note that if a potential move to T+1 settlement resulted 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 may also be an increase in the number of market claims and subsequently late matching penalties.

<ESMA_QUESTION_CSDR_6>

Q7 Do you agree with ESMA's proposal to establish a threshold beyond which more recent reference data shall be used for the calculation of the related cash penalties to prevent the degradation of the performance of the systems used by CSDs? Please also state the reasons for your answer.

<ESMA_QUESTION_CSDR_7>

Clearstream:

We have no demand for a threshold but also no objections when a threshold would be applied instead of using "infinite" historical data to align with the current T2S approach. However, **system changes on the level of any platforms/CSDs should be avoided by making them optional**.

<ESMA_QUESTION_CSDR_7>

Q8 **Do you agree with the threshold of 92 business days or 40 business days in order to prevent the degradation of the performance of the systems used by CSDs? Please specify which threshold would be more relevant in your view:**

a)92 business days;

b)40 business days;

c)other (please specify).

Please also state the reasons for your answer and provide data where available, in particular regarding the number and value of late matching instructions that go beyond 92 business days, 40 business days in the past or another threshold you think would be more relevant, and the percentage they represent compared to the overall number and value of settlement fails on a monthly basis (please use as a reference the period June 2022 – December 2023).

<ESMA_QUESTION_CSDR_8>

Clearstream:

See our answers to Questions 5 and 7.

<ESMA_QUESTION_CSDR_8>

Q9 **Do you agree that the issuer CSD for each financial instrument shall be responsible for confirming the relevant reference data to be used for the related penalties calculation? Please also state the reasons for your answer.**

<ESMA_QUESTION_CSDR_9>

Clearstream:

Clearstream is not sure why this question is being posed by ESMA, we see no need to change the current reference data sourcing approaches and responsibilities as there is always only one CSD or platform that is actually calculating the penalties.

Creating another dependency/complexity on Issuer-CSDs to provide reference data across systems to other CSDs must be avoided and appears unreasonable. Also, it is unclear in such

case how data from Issuer-CSDs outside the EU/EEA could be covered at all for penalty purposes.

Instead, we repeat our strong recommendation for ESMA to centrally provide and publish all reference data needed to calculate penalties in a single database accessible to all stakeholders.

<ESMA_QUESTION_CSDR_9>

Q10 In your view, where settlement instructions have been matched after the intended settlement date, and that intended settlement date is beyond the agreed number of business days in the past, the use of more recent reference data (last available data) for the calculation of the related cash penalties should be optional or compulsory? Please also state the reasons for your answer.

<ESMA_QUESTION_CSDR_10>

Clearstream:

To limit implementation efforts for CSDs, the use of reference data up to or older than 40 days should be **optional**.

<ESMA_QUESTION_CSDR_10>

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

<ESMA_QUESTION_CSDR_11>

Clearstream:

Though system changes to the current penalty mechanism should be avoided, Clearstream believes that **the latest available reference price should be used to calculate any late matching penalties.** I.e. the reference price as applicable on the actual late matching date should apply for any past fail day from ISD up to matching day minus 1 Business day.

Benefits:

- Same price used for LMFPs used for all past fail days;

- Less penalties calculation complexity;
- The latest available (market) price represents the “current/ actual cost” of a fail.

Costs:

- IT implementation and testing cost (medium).

<ESMA_QUESTION_CSDR_11>

Q12 Do you agree with the approach followed to incorporate proportionality in the Technical Advice? If not, please provide an indication of further proportionality considerations, detailed justifications and alternative wording as needed.

<ESMA_QUESTION_CSDR_12>

Clearstream:

We agree to **optionally** allow to limit the age of reference data used to calculate penalties.

However, we believe proportionality would be best achieved by ESMA to centrally provide and publish all reference data needed to calculate penalties in a single database being accessible to all stakeholders.

<ESMA_QUESTION_CSDR_12>

Q13 What costs and benefits do you envisage related to the implementation of the approach proposed by ESMA? Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA_QUESTION_CSDR_13>

Approach proposed by ESMA		
	Qualitative description	**Quantitative description/ Data**
Benefits	None as no change to existing processes (data must still be captured/	None

	sourced on a daily basis but may only be historized earlier than today).	
Compliance costs: **- One-off** **- On-going**	One-off: IT development, testing (incl. with T2S), implementation. On-going: no change compared to today.	One-off: IT cost, medium On-going: no change compared to today.
Costs to other stakeholders	Adapt penalty calculation process (incl. by T2S).	Unknown
Indirect costs	Unknown	Unknown

Clearstream:

For Clearstream, we do not see relevant benefits in ESMA´s change proposal.

Instead, as stated in Q11, we believe it would be a leaner approach when the reference price as applicable on the actual late matching date would be used to calculate any penalties between the ISD and the actual matching date minus 1 BD.

<ESMA_QUESTION_CSDR_13>

Q14 If applicable (if you have suggested a different approach than the one proposed by ESMA), please specify the costs and benefits you envisage related to the implementation of the respective approach. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA_QUESTION_CSDR_14>

Approach proposed by respondent (if applicable)		
	Qualitative description	**Quantitative description/ Data**
Benefits		
Compliance costs: **- One-off** **- On-going**		
Costs to other stakeholders		
Indirect costs		

Clearstream:

Similar cost/ benefits as stated in Q13 would apply.

<ESMA_QUESTION_CSDR_14>

Q15 Based on your experience, what has been the impact of CSDR cash penalties on reducing settlement fails (by type of asset as foreseen in the Annex to Commission Delegated Regulation (EU) 2017/389 since the application of the regime in February 2022? Please provide data and arguments to justify your answer.

<ESMA_QUESTION_CSDR_15>

Clearstream:

If some CSDs have lower settlement fail rates than others, applying the penalty mechanism at individual CSD [or CSD SSS] level (based on the CSD settlement fail rates) **would not be the right approach** due to the interconnectedness of securities markets and among CSDs in the EEA (cross-CSD transactions) and **could be severely damaging to the EU capital markets** as well as for cross-border settlement flows with impacted CSDs.

Definitely, CSDR penalties as well as complementary measures (like the working arrangements with relevant clients) significantly increased awareness of the importance of

timely settlement (for at least some transactions as the SDR scope is currently too wide, see our comments to Questions 6 and 16) and have clearly contributed to a reduction of the settlement fails what is also visible in Clearstream´s monthly and annual settlement efficiency 2023 data as reported to our regulators: as per the monthly CSDR settlement fails reports provided by CBL and CBF in 2023, the “by volume” fail rates almost steadily decreased from January 2023 to December 2023; also, the annual settlement efficiency data published by Clearstream shows a significant increase in the “by volume” and “by value” settlement efficiency rates for 2023 compared to 2022.

No relevant changes could be observed on specific asset type levels. Especially ETFs instruments (and subsequently those participants significantly active in the ETF business) continuously show comparably low settlement efficiency levels due to the currently complex processes. In this context, like other primary market activities, we propose that the settlement of (any) Investment Funds subscriptions/ redemptions/ switch orders should be exempted from the CSDR settlement discipline regime (SDR) scope 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). Second, 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 simply applying penalty fees is no effective means of improvement, if anything financial penalties make product (ETF) less efficient by forcing additional expense (penalty fees) to be factored into the product's profile in the form of wider spreads, a cost which is ultimately born by 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.

Further, we are of the opinion that the ongoing discussions around shortening the settlement cycle from T+2 to T+1 or even T+0 to align with the U.S. should be contemplated. Nevertheless, we believe that both investment funds' and ETFs' orders should be exempted.

Additional rationale for Investment Funds: settlement process for investment funds may not align with the requirements of CSDR SDR as there is more complexity. Indeed, multiple parties are involved (fund managers, Transfer Agents, Custodians….), different cut offs and the need to compute an NAV before the final subscription/redemption amount can be determined as well as the settlement cycle of investment funds can vary from fund to fund and is even longer than for “mainstream” securities.

Open-ended funds need to meet certain liquidity needs (meeting redemption requests without significantly jeopardizing fund's performance or affecting investors who remain invested in the fund). Exempting investment funds from the SDR provides more flexibility to funds to manage their liquidity, especially during times increased redemptions.

Switch orders” involve transferring investments between different funds within the same fund family. Exempting such transactions from the SDR avoids disrupting the settlement process for these specific transactions, contributing to smoother operations' flow and minimizing potential market impact associated with such internal transfers within investment funds.

We shall exempt Investment Funds from the SDR for market stability purposes: 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.

Investor protection assurance: 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.

Additional rationale for ETFs: Settlement fails might hit hard the ETF industry as ETFs are more prone to late settlement due to the connection between primary and secondary markets. And market participants would just pass on the cost of settlement fails to the end investor with wider bid ask spreads. Additionally, the penalty mechanism could ultimately disrupt ETFs' liquidity.

Comments applying to both ETFs and funds: keeping in mind that some jurisdictions like the UK have decided not to implement the Settlement Discipline Regime. Thus, applying in the EU to funds and ETFs (which are more complex by nature) would only create additional regulatory divergence for funds and ETFs operating in multiple jurisdictions.

<ESMA_QUESTION_CSDR_15>

Q16 In your view, is the current CSDR penalty mechanism deterrent and proportionate? Does it effectively discourage settlement fails and incentivise their rapid resolution? Please provide data and arguments to justify your answer.

<ESMA_QUESTION_CSDR_16>

Clearstream:

Also considering feedback from its clients, Clearstream believes that the SDR scope is currently too wide as it goes beyond the settlement of trading activity and covers as well participants´ internal and other specific transactions such as:

- Share registration (especially relevant for the German market/CBF);
- Transfers between the same participant accounts (e.g. acc. 1234 delivers to 1234) or between main and sub-accounts (e.g. acc. 1234 000 delivers to 1234 001; e.g. due to TEFRA D bookings CBF) of the same participant;
- Portfolio transfers between the same and/or different accounts/participants;
- Market claims/ transformations (“corporate actions on flow”; see our answer to Q6 as well);
- Investment funds redemptions/subscriptions/switch orders settlement and other primary market transactions.

In line with our participants, we therefore strongly recommend to adjust the scope of transactions subject to penalties and settlement fails reporting for ESMA to focus actions on data that is truly relevant regarding settlement and financial risk aspects and remove at least the activities listed above from consideration in future.

For the sake of completeness, it should be noted that none of these transactions should ever be made subject to buy-ins.

<ESMA_QUESTION_CSDR_16>

Q17 What are the main reasons for settlement fails, going beyond the high level categories: "fail to deliver securities", "fail to deliver cash" or "settlement instructions on hold"? Please provide examples and data, as well as arguments to justify your answer.

<ESMA_QUESTION_CSDR_17>

Clearstream:

During 2023, we observed multiple main fail reasons as stated in the "Clearstream settlement efficiency - Observations and measures" document shared with ESMA in September 2023:

- Participants need to comply with asset protection rules, i.e. assets are only released for settlement once the relevant underlying client actually holds the needed security position; until then, settlement instructions are put "on hold" or only sent to the CSD once the securities are available (that may indeed be after the Intended Settlement Date).

- Some participants use, for risk mitigation purposes (custodian default), multiple custodians in parallel, hence, "position coverage realignments" between their chosen sub-custodians are the result and slow down the overall and sometimes exhaustive settlement chains.

- CBF and its participants are by far the most active users of cross CSD settlement in T2S. CBF participants reported issues due to complex instruction formats and deadlines which increase the risk to send correct instructions late for matching and/ or settlement. Some participants consider the unique German market design causes additional complexity as CBF is the only CSDR CSD that is running two different SSS´s in parallel, namely CBF (CASCADE/T2S) and CBF-i (Creation). As a large number of

foreign ISIN´s are eligible for trading on DE Stock exchanges and eligible for settlement in both, CBF and CBF-i, although the underlying clients´ trading books might be flattened by the end of the trading day, different places of settlement may need to be handled so realignments between CBF and CBF-i are standard to cover lack of holdings in either account – such complexity does not exist within other European CSD.

- CBF processes the settlement of German Stock Exchanges trades of CBF participants´ underlying clients; this includes a huge portion of broker/dealer/market maker and retail clients´ activities, including trading in many foreign instruments and ETFs, that generate a significant settlement volume (and possibly fails due to DE market structural aspects (like “Makleraufgabegeschäft”).

- Further to the above, when the Clearstream participants´ clients are market makers, securities sold by these clients are either being safekept by various custodians and CSDs or the positions taken have to be covered on different markets, the movement of securities or execution of trades can be delayed.

- Intra-day in/ out trading activity of underlying clients that are brokers causes settlement Instructions often turning in circles between those participants until the first in the chain initially receives the shares which are then passed through the different participants settling the instructions one after another, i.e. a single fail blocks multiple “linked” transactions from settlement.

- Settlement efficiency depends on the Clearstream participants´ underlying clients (as many participants are acting as a broker/ clearing agent/ custodian for clients); in those set-ups, most fails are caused only by a few underlying clients.

- Some participants demand (1) an increase of partial settlement windows for Clearstream internal and for Bridge settlements and (2) offer partial delivery for EU domestic markets, where possible or (3) require new or increased credit line facilities to avoid “lack of cash” fails or consider using securities lending services.

- For CBF, a significant number of failed DE registered shares (“CASCADE RS”) “high value” free of payment share registration orders occurred.

- While T2S cancels pending matched transactions after 60 days, this is not (yet) the case for CBL, CBF-i hence, fails continue to occur for multiple months when instructions are only unilaterally cancelled (and the counterparty has no incentive to cancel its instruction when it is receiving credit penalties) or the customer does not have the instruction in its records anymore (often the case for market claims or corporate actions related items for unknown reasons).

- Time zone differences may as well cause late settlement by Clearstream participants: for example, participants that realign positions from the US market to Clearstream can only use the securities for same day settlement in EU markets if the US securities are delivered prior to the closing of the EU market.

- Due to Ukraine/ Russia sanctions measures, since April 2022 a significant increase in the number of CBL participants´ (underlying clients) accounts and transactions are blocked from settlement. Such transactions are not exempt from the settlement (fails) reporting. This generally negatively impacts the efficiency rates and no mitigation measures can be taken.

- As 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 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 Clearstream. However, it would even be impossible for CSDs to identify such fail reasons and "global" aspects.

<ESMA_QUESTION_CSDR_17>

Q18 What tools should be used in order to improve settlement efficiency? Please provide examples and data, as well as arguments to justify your answer.

<ESMA_QUESTION_CSDR_18>

Clearstream:

From a CSD perspective, the extended use of "hold & release" as well as partial settlement/ partial release functionalities and securities lending services for fails coverage by the participants could further enhance settlement efficiency.

However, processes that are performed prior that settlement instructions are sent to the CSD should also be assessed by the relevant stakeholders to complete the picture and address issues that already occur much earlier, e.g. on trading level.

Please refer to the AFME assessment on settlement efficiency as published in October 2023: https://www.afme.eu/publications/reports/details/improving-the-settlement-efficiency-landscape-in-europe

<ESMA_QUESTION_CSDR_18>

Q19 **What are your views on the appropriate level(s) of settlement efficiency at CSD/SSS level, as well as by asset type? Please provide data and arguments to justify your answer.**

<ESMA_QUESTION_CSDR_19>

Clearstream:

As stated in our answer to Q16, we strongly recommend adjusting the scope of transactions subject to penalties and settlement fails reporting for ESMA to focus actions on data that is truly relevant regarding settlement and financial risk aspects and remove e.g. the participants´ internal activity from consideration in future.

Only then, an achievable and realistic level of efficiency may be jointly assessed by all stakeholders.

<ESMA_QUESTION_CSDR_19>

Q20 **Do you think the penalty rates by asset type as foreseen in the Annex to Commission Delegated Regulation (EU) 2017/389 are proportionate? Please provide data and arguments to justify your answer.**

<ESMA_QUESTION_CSDR_20>

Clearstream:

This is not for Clearstream to judge but in general **we are concerned that the competitiveness of the EU capital markets could be negatively impacted by the application of overly high (or even extreme) daily penalty rates.**

<ESMA_QUESTION_CSDR_20>

Q21 **Regarding the proportionality of the penalty rates by asset type as foreseen in the Annex to Commission Delegated Regulation (EU) 2017/389, ESMA does not have data on the breakdown of cash penalties (by number and value) applied by CSDs by asset type. Therefore, ESMA would like to use this CP to ask for data from all EEA CSDs on this breakdown, including on the duration of settlement fails by asset type.**

<ESMA_QUESTION_CSDR_21>

Clearstream:

We currently have no ability to provide such data.

<ESMA_QUESTION_CSDR_21>

Q22 In your view, would progressive penalty rates that increase with the length of the settlement fail be justified? Please provide examples and data, as well as arguments to justify your answer.

<ESMA_QUESTION_CSDR_22>

Clearstream:

Considering our answers to Questions 16 and 17, given the variety of (structural and operational) reasons for settlement fails, we believe that the root causes for fails are not yet fully understood and actioned upon. Hence, no changes to the penalty calculations approach should be made at this stage as we have reasonable doubts that a (largely extremely significant) increase of the penalties would actually lead to more timely settlements overall. **Instead, the root cause assessments of the stakeholders on "actionably avoidable" items should be continued and documented.**

Without entering the consideration of whether adjusting penalty rates could have a positive effect on settlement efficiency, we also would like to highlight that:

- the CSDR penalty mechanism is only two years in operations which is a very limited timespan to draw any conclusions on the effectiveness of the current cash penalties regime and whether implementing a change is warranted, especially considering that after a technical stabilisation phase, CSDs and their participants continue to educate their clients with the requirements of the penalty regime;

- recurring settlement fails represent a minority of overall fails, thus the rationale and benefits for introducing progressive penalty rates are unclear;

- the introduction of progressive penalty rates would be a material technical and operational change to the computation logic, requiring significant IT developments (including testing) for any EU/EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails).

We note that the term "*Day*" used in the ESMA table "Option 1" (page 35) as well as in the "Option 2 - Example 2" on pages 56, 57 should be clarified and understood as "Business day", not "Calendar day".

ECAG:

Rational for the view of ECAG on progressive penalty rates:

CCPs as central counterparties to clearing members are always located between securities delivering and receiving clearing members and the related settlement parties at the CSDs. The CCP is buyer to the selling parties and deliverer to the receiving parties. There is no 1:1 relation between selling and receiving parties. Based on Eurex Clearing AG's rules, ECAG always delivers to the buyer with the oldest pending securities instruction. With current fixed penalty rates over the different days late of an instruction, the days late of pending instructions in remaining seller/buyer constellation does not make a difference in the total net penalty balance of the assumed constellation. With progressive penalty rates on days late, the older pending delivery instruction could constitute a higher penalty to be paid to the CCP than the CCP must pay to the remaining buyer with fewer days pending instruction, thereby leading to a systematic surplus for the CCP.

Progressive penalty rates based on failed value raises the risk for systematic imbalances for CCPs in both directions (loss and surplus from a CCP view). As there is no 1:1 relation between selling and receiving parties, resulting instructions after clearing differ on CCP sell and buy side in related instruction value.

<ESMA_QUESTION_CSDR_22>

Q23 What are your views regarding the introduction of convexity in penalty rates as per the ESMA proposed Option 2 (settlement fails caused by a lack of liquid financial instruments)? Please justify your answer by providing quantitative examples and data if possible.

<ESMA_QUESTION_CSDR_23>

Clearstream:

Focusing solely on liquidity when calculating penalties would represent a significant change compared to the current approach. The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/EEA CSDs, T2S and participants and would make the application of penalty rates further more complex for transactions failing for more than one day (and including late matching fails).

Option 2 would, compared to the option 1, imply a structural change in the penalty mechanism methodology with regard to the derivation of asset classes, i.e. moving from a classification based primarily on asset type, using the CFI code of a security to determine which penalty rate to apply, to a liquidity indicator basis (liquid/ illiquid would become the main indicator to determine the penalty rate). Thus the Option 2 represents the highest impact on the penalty mechanisms and would require the longest implementation timeframe.

When it comes to Option 1, the sole application of a dedicated penalty rate for ETFs (without introducing progressive rates) could be achieved via current methodology, i.e. with a new category of CFI code (for ETFs) determining a specific penalty rate, which would comparatively represent a small to medium functional impact.

Amending the current methodology with any other breakdown (be it the type of transaction, the duration of the fail or any other criterion) would add even further complexity to the penalty mechanism, which could be in contradiction with ESMA's objectives of having a lean penalty mechanism.

ECAG:

As explained in our answers to questions Q2/Q22/Q30, ECAG considers progressive penalty rates (with or without convexity) as a reason for systematic penalty imbalances for CCPs.

<ESMA_QUESTION_CSDR_23>

Q24 Would it be appropriate to apply the convexity criterion to settlement fails due to a lack of illiquid financial instruments as well? Please justify your answer by providing quantitative examples and data if possible.

<ESMA_QUESTION_CSDR_24>

Clearstream:

Please see our response to Question 23.

<ESMA_QUESTION_CSDR_24>

Q25 What are your views regarding the level of progressive penalty rates:

a) as proposed under Option 1?

b) as proposed under Option 2?

<ESMA_QUESTION_CSDR_25>

Clearstream:

Please see our response to Questions 22 and 23.

For the sake of clarity we note that already today ETFs (category “ETFS”) are penalized in the same way as the categories “SECU”, “UCIT”, “EMAL” and “other” instruments (per fail day, 0.50/0.25 bp´s apply) and we see no obvious reason why a new category for ETFs should be added.

ECAG:

Please refer to answers in Q2/Q22/Q30

<ESMA_QUESTION_CSDR_25>

Q26 If you disagree with ESMA’s proposal regarding the penalty rates, please specify which rates you believe would be more appropriate (i.e. deterrent and proportionate, with the potential to effectively discourage settlement fails, incentivise their rapid resolution and improve settlement efficiency). Please provide examples and data, as well as arguments to justify your answer. If relevant, please provide an indication of further proportionality considerations, detailed justifications and alternative proposals as needed.

<ESMA_QUESTION_CSDR_26>

Clearstream:

While we cannot comment on the appropriate level of the penalty rates, we caution that the introduction of new calculation criteria like the length or value of a settlement fail or solely the security liquidity would require relevant IT developments (including testing) for any EU/EEA CSDs, T2S and participants and would make the calculation of penalties by all relevant stakeholders much more complex for transactions failing for more than one day (including late matching fails).

We also doubt there is a reasonable cost/benefit ratio for such developments.

In any case, **we are highly concerned that the competitiveness of the EU capital markets could be negatively impacted by the application of overly high (even extreme) daily penalty rates.**

<ESMA_QUESTION_CSDR_26>

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

a) as proposed under Option 1?

b) as proposed under Option 2?

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

<ESMA_QUESTION_CSDR_27>

Clearstream:

To summarize our understanding:

Option 1: per instrument type (SHRS, SOVR…), for every fail day 1 to 6, a different rate (basis point) applies to calculate the penalty; as of day 6 and after, the rate remains stable;

Option 2: penalty rates to be based on security liquidity/ illiquidity or cash amount (i.e. only 3 categories to consider), for every fail day 1 to 6 and after, a different rate (basis point) applies to calculate the penalty (note: for “liquid” ISINs the rate of day 6 and after would be lowered back to the one of day 3…).

In both options, a new table/ logic for rates “by fail day” (i.e. length of the fail) needs to be implemented, for Option 2, the refence data needs to be changed to apply “liquid”/ “illiquid” categories to all ISINs and change (remove) the current logic for cash fails to no longer apply the Central Bank discount rates but use daily increasing basis points.

The two suggested options would represent a significant change compared to the current penalties calculation approach. The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails).

<ESMA_QUESTION_CSDR_27>

Q28 What costs and benefits do you envisage related to the implementation of progressive penalty rates by asset type (according to ESMA's proposed Options 1 and 2)? Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA_QUESTION_CSDR_28>

Progressive penalty rates (by asset type) - ESMA's proposal Option 1	**Please see ESMA's proposed Option 1 in Section 5.3 of this CP.**	
	Qualitative description	**Quantitative description/ Data**
Benefits	None	None
Compliance costs: **- One-off** **- On-going**	One-off: IT development On-going: reference data sourcing	On-off: IT, medium On-going: same as today
Costs to other stakeholders	T2S development, client testing	Unknown
Indirect costs	Unknown	Unknown
Progressive penalty rates (by asset type) - ESMA's proposal Option 2	**Please see ESMA's proposed Option 2 in Section 5.3 of this CP.**	
	Qualitative description	**Quantitative description/ Data**
Benefits	None	None

Compliance costs: **- One-off** **- On-going**	One-off: IT development On-going: reference data sourcing	On-off: IT, high/ On-going: same as today
Costs to other stakeholders	T2S development, client testing	Unknown
Indirect costs	Unknown	Unknown

Clearstream:

The two suggested options would represent a significant change compared to the current penalties calculation approach. The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/ EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails).

<ESMA_QUESTION_CSDR_28>

Q29 Alternatively, do you think that progressive cash penalties rates should take into account a different breakdown than the one included in ESMA's proposal above for any or all of the following categories:

(a) asset type;

(b) liquidity of the financial instrument;

(c) type of transaction;

(d) duration of the settlement fail.

If you have answered yes to the question above, what costs and benefits do you envisage related to the implementation of progressive penalty rates according to your proposal? Please use the table below. Where relevant,

additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA_QUESTION_CSDR_29>

Clearstream:

The consideration of any new criteria would represent a significant change compared to the current approach. The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/ EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails).

Note: as discussed during the CSDR consultations some years ago, the transaction type is not a matching criteria for settlement transactions, hence, the information could deviate between the securities delivery and receipt leg of a transaction making the application of penalties based on this criteria “random” at best.

The addition of further criteria to be considered to calculate penalties will increase (at least double) the cost as estimated in our feedback to Question 28.

Progressive penalty rates – respondent's proposal *(if applicable)*		
	Qualitative description	**Quantitative description/ Data**
Benefits	None	None
Compliance costs: **- One-off** **- On-going**	One-off: IT development On-going: reference data sourcing	On-off: IT, high On-going: same as today
Costs to other stakeholders	T2S development, client testing	Unknown
Indirect costs	Unknown	Unknown

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<ESMA_QUESTION_CSDR_29>

Q30 Another potential approach to progressive penalty rates could be based not only on the length of the settlement fail but also on the value of the settlement fail. Settlement fails based on instructions with a lower value could be charged a higher penalty rate than those with a higher value, thus potentially creating an incentive for participants in settling smaller value instructions at their intended settlement date (ISD). Alternatively, settlement fails based on instructions with a higher value could be charged a higher penalty rate than those with a lower value. In your view, would such an approach be justified? Please provide arguments and examples in support of your answer, including data where available. What costs and benefits do you envisage related to the implementation of this approach? Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA_QUESTION_CSDR_30>

Clearstream:

Please see our feedback to Questions 27 to 29.

The consideration of any new criteria would represent a significant change compared to the current approach. The cost/benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails).

Progressive penalty rates – based on the length and value of the settlement fail	**Settlement fails based on lower value settlement instructions could be charged a higher penalty rate than those based on higher value settlement instructions**	**Settlement fails based on higher value settlement instructions could be charged a higher penalty rate than those based on lower value settlement instructions**

	Qualitative description	Quantitative description/ Data	Qualitative description	Quantitative description/ Data
Benefits	None	None	None	None
Compliance costs: **- One-off** **- On-going**	One-off: IT development On-going: reference data sourcing	On-off: IT, high On-going: same as today	One-off: IT development On-going: reference data sourcing	On-off: IT, high On-going: same as today
Costs to other stakeholders	T2S development, client testing	Unknown	T2S development, client testing	Unknown
Indirect costs	Unknown	Unknown	Unknown	Unknown

ECAG:

As explained in our answer to Q2/Q22 progressive penalty rates based on failed value may lead to a risk for systematic imbalances for CCPs in both directions (loss and surplus in CCP view). As there is no 1:1 relation between selling and receiving parties, resulting instructions after clearing differ on CCP sell and buy side in related instruction value.

<ESMA_QUESTION_CSDR_30>

Q31 Besides the criteria already listed, i.e. type of asset, liquidity of the financial instruments, duration and value of the settlement fail, what additional criteria should be considered when setting proportionate and effective cash penalty rates? Please provide examples and justify your answer.

<ESMA_QUESTION_CSDR_31>

Clearstream:

No additional criteria should be considered as this would represent a significant change compared to the current approach. The cost/benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/EEA CSDs, T2S and participants and would make the application of penalty rates much more complex for transactions failing for more than one day (and including late matching fails).

<ESMA_QUESTION_CSDR_31>

Q32 Would you be in favour of the use of the market value of the financial instruments on the first day of the settlement fail as a basis for the calculation of penalties for the entire duration of the fail? ESMA would like to ask for the stakeholders' views on the costs and benefits of such a measure. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA_QUESTION_CSDR_32>

Clearstream:

We interpret ESMA´s question to be aimed at LMFPs.

For late matching penalties, as stated in our response to Question 11, Clearstream believes that the reference price as applicable on the actual late matching date should be used to calculate any late matching penalties.

Despite IT development impacts this would simplify the way penalties are being calculated for past fail dates between ISD and actual matching date.

Use 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		
	Qualitative description	**Quantitative description/ Data**
Benefits	Less complex LMFP calculation	None
Compliance costs: **- One-off** **- On-going**	One-off: IT, low On-going: same as today	One-off: low, (excluding testing) On-going: same as today
Costs to other stakeholders	T2S implementation, client testing	Unknown
Indirect costs	None	None

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<ESMA_QUESTION_CSDR_32>

Q33 How should free of payment (FoP) instructions be valued for the purpose of the application of cash penalties? Please justify your answer and provide examples and data where available.

<ESMA_QUESTION_CSDR_33>

Clearstream:

We see no need for changes, the current process should continue to apply.

<ESMA_QUESTION_CSDR_33>

Q34 Do you think there is a risk that higher penalty rates may lead to participants using less DvP and more FoP settlement instructions? Please justify your answer and provide examples and data where available.

<ESMA_QUESTION_CSDR_34>

Clearstream:

We are not in a position to judge this but the replacement of DVPs by FOPs seems very unlikely.

<ESMA_QUESTION_CSDR_34>

Q35 ESMA is considering the feasibility of identifying another asset class subject to lower penalty rates: "bonds for which there is not a liquid market in accordance with the methodology specified in Article 13(1), point (b) of Commission Delegated Regulation (EU) 2017/583 (RTS 2)". The information on the assessment of bonds' liquidity is published by ESMA on a quarterly basis and further updated on FITRS. However, ESMA is also aware that this may add to the operational burden for CSDs that would need to check the liquidity of bonds before applying cash penalties. As such, ESMA would like to ask for the stakeholders' views on the costs and benefits of such a measure. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA_QUESTION_CSDR_35>

Applying lower penalty rates for illiquid bonds		
	Qualitative description	**Quantitative description/ Data**
Benefits	None	N/A
Compliance costs: **- One-off** **- On-going**	One-off: IT development On-going: same as today	One-off: IT, low On-going: same as today
Costs to other stakeholders	T2S development	Unknown

Indirect costs	Unknown	Unknown

Clearstream:

We have no objections to consider bond-liquidity in the penalty calculation as long as the required data can be sourced the same way as done for shares already today (i.e. using the ESMA FITRS database).

However, as ESMA states “The latest bonds quarterly liquidity assessment published on 31 October 2023 identifies 1,148 liquid bonds (sovereign and corporate ones) out of 124,197 bonds subject to MiFID II transparency requirements for Q3 2023, meaning that most of the bonds would be considered illiquid.”, we question the actual benefit of such approach as less than 1% of the bonds in scope would be “liquid” so we believe the cost/ benefit ratio is not convincing to justify such system change that would have to be implemented by any EU/EEA CSDs and T2S.

We also repeat our strong recommendation for ESMA to centrally provide and publish all reference data needed to calculate penalties in a single database accessible to all stakeholders.

<ESMA_QUESTION_CSDR_35>

Q36 Do you have other suggestions for further flexibility with regards to penalties for settlement fails imposed on illiquid financial instruments? Please justify your answer and provide examples and data where available.

<ESMA_QUESTION_CSDR_36>

Clearstream:

We have nothing to add.

<ESMA_QUESTION_CSDR_36>

Q37 How likely is it that underlying parties that end up with “net long” cash payments may not have incentives to manage their fails or bilaterally cancel failing instructions as they may “earn” cash from penalties? How could this risk

be addressed? Please justify your answer and provide examples and data where available.

<ESMA_QUESTION_CSDR_37>

Clearstream:

We have indeed detected cases where transactions are only unilaterally cancelled and remain subject to continuous penalties; the reason why bilateral cancellation is not applied by the counterparty is unknown to us but apparently participants do not always succeed to make their counterparty confirm the cancellation request.

T2S cancels even matched failing settlement transactions after 60 days so the issue is limited to 2 months from a T2S "efficiency" perspective. Applying the same approach by all (I)CSDs could mitigate the issue.

<ESMA_QUESTION_CSDR_37>

Q38 **How could the parameters for the calculation of cash penalties take into account the effect that low or negative interest rates could have on the incentives of counterparties and on settlement fails? Please provide examples and data, as well as arguments to justify your answer.**

<ESMA_QUESTION_CSDR_38>

Clearstream:

Please refer to our answer to Question 1.

<ESMA_QUESTION_CSDR_38>

Q39 **To ensure a proportionate approach, do you think the penalty mechanism should be applied only at the level of those CSDs with higher settlement fail rates? Please provide examples and data, as well as arguments to justify your answer. If your answer is yes, please specify where the threshold should be set and if it should take into account the settlement efficiency at:**

a) CSD/SSS level (please specify the settlement efficiency target);

b) at asset type level (please specify the settlement efficiency target); or

c) other (please specify, including the settlement efficiency target).

<ESMA_QUESTION_CSDR_39>

Clearstream:

No, the penalty mechanism must not be applied only at the level of those CSDs with higher settlement fail rates as **this would heavily damage (intra- and outside EU/EEA) competition and level-playing field and target the wrong entities** as CSDs are not the ones who could significantly steer the settlement efficiency of their participants.

<ESMA_QUESTION_CSDR_39>

Q40 Please specify what costs and benefits you envisage regarding the application of the penalty mechanism only at the level of the CSDs with higher settlement fail rates. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA_QUESTION_CSDR_40>

Application of the penalty mechanism only at the level of CSDs with lower settlement fail rates		
	Qualitative description	**Quantitative description/ Data**
Benefits	None	N/A
Compliance costs: **- One-off** **- On-going**	One-off IT: none On-going: no change	One-off IT: none On-going: no change
Costs to other stakeholders	Impact on T2S (to calculate penalties only for some CSDs)	Unknown but expected significant

Indirect costs	Unknown	Unknown

Clearstream:

In addition to our response to Question 39, especially for T2S CSDs, **such approach would be extremely counterproductive:** for T2S and its participants, the running and development cost of the penalty mechanism would be attributed to a much smaller customer base, hence, heavily increase the cost distributed to few CSDs and clients what will **make the use of such CSDs or even T2S unreasonable.**

<ESMA_QUESTION_CSDR_40>

Q41 Do you think penalty rates should vary according to the transaction type? If yes, please specify the transaction types and include proposals regarding the related penalty rates. Please justify your answer and provide examples and data where available. Please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

<ESMA_QUESTION_CSDR_41>

Clearstream:

As discussed during the CSDR consultations some years ago, the transaction type is not a matching criteria for settlement transactions, hence, the information could deviate between the securities delivery and receipt leg of a transaction making the application of penalties based on this criteria “random” at best.

The cost/ benefit ratio is too low to justify any change that will require relevant IT developments (including testing) for any EU/EEA CSDs, T2S and participants and would make the application of penalty rates much more complex.

Applying penalty rates by transaction types		
	Qualitative description	**Quantitative description/ Data**

Benefits	None	N/A
Compliance costs: **- One-off** **- On-going**	One-off: IT development On-going: same as today	One-off: IT, medium (excl. testing) On-going: same as today
Costs to other stakeholders	T2S system implementation; client testing	Unknown
Indirect costs	Unknown	Unknown

<ESMA_QUESTION_CSDR_41>

Q42 Do you think that penalty rates should depend on stock borrowing fees? If yes, do you believe that the data provided by data vendors is of sufficient good quality that it can be relied upon? Please provide the average borrowing fees for the 8 categories of asset class depicted in Option 1. (i.e. liquid shares, illiquid shares, SME shares, ETFs, sovereign bonds, SME bonds, other corporate bonds, other financial instruments).

<ESMA_QUESTION_CSDR_42>

We are not in agreement for such an approach since the fees applied on the securities lending and borrowing (SLB) transactions are driven by market conditions (i.e. special vs general collateral) for a specific period. Recognizing that the state of liquidness of the security can lead to higher fees (i.e. Specials), this should not be the driver of setting the penalty fees. Settlement fails could be the result of various elements in the trading and settlement chain. **Such approach could further hinder the SLB activity** rather than increasing the settlement efficiency.

Additionally, implementation and monitoring, reconciliation of such a variable to define the penalty fee would require extensive IT and process development by all stakeholders.

<ESMA_QUESTION_CSDR_42>

Q43 **Do you have other suggestions to simplify the cash penalty mechanism, while ensuring it is deterrent and proportionate, and effectively discourages settlement fails, incentivises their rapid resolution and improves settlement efficiency? Please justify your answer and provide examples and data where available. Please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.**

<ESMA_QUESTION_CSDR_43>

Clearstream:

We have nothing to add beyond what we mentioned already in multiple previous questions.

If ESMA believes that the current penalty rates are to be increased, **a simple adjustment of the current rates without adding technical complexities or making structural changes would be the leanest and most proportionate approach.**

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

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CSDR_43>

Q44 **Based on your experience, are settlement fails lower in other markets (i.e USA, UK)? If so, which are in your opinion the main reasons for that? Please also specify the scope and methodology used for measuring settlement efficiency in the respective third-country jurisdictions.**

<ESMA_QUESTION_CSDR_44>

Clearstream:

Please refer to the response provided by the European CSDs Association (ECSDA).

<ESMA_QUESTION_CSDR_44>

Q45 **Do CSD participants pass on the penalties to their clients? Please provide information about the current market practices as well as data, examples and reasons, if any, which may impede the passing on of penalties to clients.**

<ESMA_QUESTION_CSDR_45>

Clearstream:

This is not for CSDs to answer.

<ESMA_QUESTION_CSDR_45>

Q46 **Do you consider that introducing a minimum penalty across all types of fails would improve settlement efficiency? Is yes, what would be the amount of this minimum penalty and how should it apply? Please provide examples and data, as well as arguments to justify your answer.**

<ESMA_QUESTION_CSDR_46>

Clearstream:

CSDs that applied a penalty regime prior to CSDR are better placed to answer this question but considering our answers to Questions 16 and 17, given the variety of (structural and operational) reasons for settlement fails, we believe that the root causes for fails are not yet fully understood and actioned upon. Hence, we have reasonable doubts that the increase of penalty rates would lead to more timely settlements overall. Also, such change would require

IT developments (including testing) for any EU/EEA CSDs, T2S and participants and would make the application of penalty rates further complex (including for late matching fails).

<ESMA_QUESTION_CSDR_46>

Q47 What would be the time needed for CSDs and market participants to implement changes to the penalty mechanism (depending on the extent of the changes)? Please provide arguments to justify your answer.

<ESMA_QUESTION_CSDR_47>

Clearstream:

From the date of issuance of the final ESMA RTS, depending on the significance of the changes required, for Clearstream internal developments and including testing with participants and T2S, at least 18 months lead time will be required.

<ESMA_QUESTION_CSDR_47>

Q48 Since the application of the RTS on Settlement Discipline, how many participants have been detected as failing consistently and systematically within the meaning of Article 7(9) of CSDR? How many of them, if any, have been suspended pursuant to same Article?

<ESMA_QUESTION_CSDR_48>

Clearstream:

As per Clearstream´s assessment procedure, in 2023, five CBF clients were identified as being in scope for further assessments (based on 2022 annual data) for both CBF settlement platforms (one client for CBF/CASCADE, four clients for CBF-I/Creation). For 2023, no CBF but two other CBF-I clients were identified. For CBL, one client was identified as being in scope for further assessment in 2023. In 2024 (based on 2023 annual data), two other clients were identified, amongst them one being sanctioned. For LuxCSD, in 2023 and 2024, no clients were identified as being in scope for further assessment.

Thanks to the constant interaction between Clearstream and the relevant clients in 2023, almost all clients increased their settlement efficiency so Clearstream will not pursue further suspension actions against them.

The applicable process is described in the Clearstream Client Handbooks chapter “CSDR Settlement Discipline Regime” section “Monitoring Settlement Fails (settlement efficiency)” in detail.

<ESMA_QUESTION_CSDR_48>

Q49 In your view, would special penalties (either additional penalties or more severe penalty rates) applied to participants with high settlement fail rates be justified? Should such participants be identified using the same thresholds as in Article 39 of the RTS on Settlement Discipline, but within a shorter timeframe (e.g. 2 months instead of 12 months)? If not, what criteria/methodology should be used for defining participants with high settlement fail rates? Please provide examples and data, as well as arguments to justify your answer.

<ESMA_QUESTION_CSDR_49>

Clearstream:

We cannot support an approach that is requiring to treat our participants differently and publicly “name and shame” them as “offenders” as the actual settlement efficiency is dependent on many factors (like structural/ legal aspects, business models, underlying client bases, financial instruments served, location/region/time-zone) that cannot always, easily or at all be influenced by the CSD and/ or its participants as illustrated in our feedback to e.g. Questions 6, 16 and 17.

Hence, an “automatic” increase of penalties for certain participants must be absolutely avoided.

It is also unclear who would benefit from such fees and how they should be processed/ paid when ESMA states “*These special penalties would be in addition to the general cash penalty mechanism provided for in CSDR. In principle, they would not be credited to the participant’s counterparties and should not represent an additional source of income for the CSD*.”

Leaving aside any IT development cost (including for T2S) we believe the existing “suspension” process (see as well Question 48) perfectly serves the purpose to incentivise relevant participants to take mitigating actions, whenever possible.

<ESMA_QUESTION_CSDR_49>

Q50 How have CSDs implemented working arrangements with participants in accordance with article 13(2) of the RTS on Settlement Discipline? How many participants have been targeted?

<ESMA_QUESTION_CSDR_50>

Clearstream:

Monthly working arrangements have been implemented in 2022; in 2023, a total of 27 CBF, 20 CBF-I, seven CBL and six LuxCSD different clients with a relevant impact on the CSD settlement efficiency were subject to the process to collect feedback on fail reasons and measures applied.

The applicable process is described in the Clearstream Client Handbooks chapter “CSDR Settlement Discipline Regime” section “Monitoring Settlement Fails (settlement efficiency)” in detail.

<ESMA_QUESTION_CSDR_50>

Q51 Should the topic of settlement efficiency be discussed at the CSDs’ User Committees to better identify any market circumstances and particular context of participant(s) explaining an increase or decrease of the fail rates? Please justify your answer.

<ESMA_QUESTION_CSDR_51>

Clearstream:

The topic is already a standing agenda item of the Clearstream and LuxCSD User Committees to raise/keep awareness for the topic and discuss (new, if any) reasons for and measures to avoid fails.

<ESMA_QUESTION_CSDR_51>