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	FRANCE POST-MARCHE
Activity	Associations, professional bodies, industry representatives
Are you representing an association?	☒
Country / Region	France

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>

We believe that the proper alternative solution when the official interest rate for overnight credit charged by the central bank issuing the settlement currency is not available lies in Option 3, which is close to the current methodology applied in T2S when such cases do occur.
These cases are extremely rare.<ESMA_QUESTION_CSDR_1>

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

<ESMA_QUESTION_CSDR_2>

We do not have other suggestions. The option chosen should remain simple, easy to explain, and at a limited cost of development.<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>

The question of proportionality raised in this question is unclear to us.
If proportionality is to be considered with regards to the cost involved in the implementation of the solution, we believe that it should be incorporated in the Technical advice, to ensure that a solution easy to implement will be chosen.

<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	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

The case considered being extremely rare, we believe a solution easy to implement should be chosen. Option 3 should come at a limited cost, being close to the current practice.

<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>

This question is for CSDs to give an answer.

<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>

LMFP can usually result mostly from the following reasons:

- Counterparties not using electronic communication means for allocation-confirmation, causing delays in the processing of the instruction
- Booking issues, such as errors in the quantity or mismatches in the cash amounts;
- Wrong SSI leading to mismatches at CSD level;
- IT issues resulting in transactions blocked in the front-to-back chain before they can be sent to the CSD or custodian;

It should also be noted that post-trade compliance controls may delay the sending of a particular instruction.

Late matching instructions lasting for a long period will usually be caused by the time required to resolve mismatches, with counterparties not agreeing on the adjustment to be made, and on which counterparty must proceed to the adjustment.

It may also be related to SSI newly created and not properly communicated to the counterparty / settlement agent.

In some cases, allocations may be received through unusual channels.

All three cases result in manual processing that take a longer time than a full-STP transaction.

Electronic processing of allocation-confirmation should be preferred, in a proper timing allowing for settlement in due time.
In all cases, the instruction should be sent to the CSD as soon as possible to identify mismatches, while putting the instruction on Hold (all across the chain) when further controls need to be made.

<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>

The use of the accurate reference data for the calculation of a LMFP is a key point in obtaining a correct penalty. Moreover, it contributes to the principle of immunization of intermediaries recalled by the regulator, should the stock be redelivered: the LFMP received later by the non-defaulting party will cover all the SEFP paid by it. However, we understand that a requirement to keep the reference data with no limit in the past may degrade the functioning of the SSS / penalty mechanism. Therefore, we agree with ESMA's proposal to allow CSDs to use a threshold.

<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>

We agree to have a threshold, but the value of this threshold should be left at the decision of the CSD. As already mentioned, the penalty mechanism should be fair and avoid penalizing participants that are not the real defaulters. Therefore, the threshold should be determined taking in account the percentage of LMFP that will be concerned. As indicated in the consultation paper, this percentage is extremely low after 40 days in a T2S environment. However, this does not mean the situation will be the same for non-T2S CSDs. Thus, it should be left at the decision of each calculating CSD/penalty mechanism to apply a threshold and define its value.

To be noted that these cases remain rare. In ESES in H2 2023:

- Late matching exceeding a duration of 40 to 91 days represent 0.03% of total penalties (LMFP+SEFP);

Late matching exceeding a duration of 92 days represent 0.005% of total penalties (LMFP+SEFP).

<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>

It is already the case for the T2S penalty mechanism. Since T2S is in charge of the calculation of the penalties for all the T2S CSDs it was logical to designate, for each financial instrument, one CSD responsible to provide the relevant reference data to the penalty mechanism from the SME of the security.

For non-T2S CSDs, the calculation is made by the calculating CSD itself based on information it obtains also from data providers (even an issuer CSD needs to get the reference price).

<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>

First of all, we consider that the volumes impacted are low.

Second, we want a standardized approach across CSDs that allows for certainty in terms of penalties calculation.
<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>

We have no other suggestion.

<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>

The question of proportionality raised in this question is unclear to us.
If proportionality is to be considered with regards to the cost involved in the implementation of the solution, we believe that it should be incorporated in the Technical advice, to ensure that a solution easy to implement will be chosen.

<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	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

This question is for CSDs to give an answer.

<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	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

This question is for CSDs to give an answer.

<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>

The look back period since the introduction of penalties is still limited in time (2 years as of today). We observe a trend towards a slight reduction of settlement fails since penalties have been introduced. Yet, a number of other factors detailed below occurred during the same period of time that may have also played a role; it appears difficult to determine the respective impact of each factor, including the penalty mechanism.

Increasing interest rates over the period may have had an impact, making the economic cost of failing to deliver securities higher.

Similarly, the unwinding of purchase programs by central banks has increased the liquidity of some instruments, and may have positively affected settlement efficiency.

From an operational perspective, it should be noted that the very introduction of penalties has brought the industry (prior to their introduction) to increase its work on settlement efficiency and to significant improvements on current processes to reduce settlement fails through the adoption and improvement of market practices and adherence to such practices by participants. Such as:

- A wider use of partial settlement, and related functionalities: hold & release, partial release;
- Adjustment of intended settlement dates in the case of portfolio transfers;
- Technical improvements such as moving the quantity for bond issuances from Unit to FAMT (Face Amount).

With regards to the use of borrowing services, the impact is still unclear: although use of auto-borrow programs at ICSDs seems to have increased, there are tensions on the securities lending market due to the entry into force of the settlement discipline (notably reduced cut-offs), which may impact the ability of market players to borrow securities closer to settlement deadlines to resolve a fail – however it does not mean that we are in favor of any exemption for securities lending and borrowing.

Yet, the penalties have had the virtue of giving a direct out-of-pocket cost to some settlement inefficiencies and incentivized market participants to improve their internal processes accordingly.

It should be noted that despite the limited insight, and even though some improvements may be made, no fundamental flaw has been detected on the key features of the penalty mechanism: categorization of assets, calculation, processing, etc.

<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>

At present, despite some cases of instructions that have generated very high penalties, in average the cost of penalties is very low:

- In ESES in December 2023, the average penalty amounted to 80,17€.
- In Euroclear in 2022, the ratio between the value of penalties and the total value of instructions was 0,0001.

To further improve settlement efficiency, the penalty mechanism should give a more significant direct incentive to the failing delivering participant to resolve the fail. It should give an incentive to optimize one's securities inventory, reduce operational inefficiencies, but most importantly it should give an incentive to find securities on the market where there is an actual lack.

With regards to “lack of securities”, when compared to the cost of borrowing securities, although such borrowing market does not exist for all types of financial instruments, it is generally considered that the cost of penalties is much lower, by a factor of 3 or 4 in present market conditions, making borrowing a much costlier option to resort to.
As a result, the penalty rates could be set at a level where the cost of fail outweighs the cost of resolving the fail.

<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>

First of all, it should be remembered that the European securities market is not unified, at the execution and post-trade level when compared to other significant financial markets. Each market has its own specificities in terms of post-trade processing.

Actual cases of “Fail to deliver cash” due to an actual lack of cash represents 0.1% in volume of instructions (December 2023, Euroclear France). Such cases will be mostly related to a misalignment of cash flows to the required cut-offs for settlement, such as sell orders not settled on time causing a lack of cash, or an unsettled FX transaction resulting in a lack of the proper currency.

“Fail to deliver securities” can result from a much wider array of reasons.

From the perspective of a trading party, SEFP can usually result mostly from the following reasons:

- Securities not received in (an)other transaction(s);
- Securities not partialized as a result of the counterparty not accepting partial settlement;
- Securities not transferred in due time from another CSD;
- Securities not recalled in due time from triparty collateral management agents / lending agents;
- Settlement instruction put on hold (see below);
- Among other reasons: linked transaction, mistmatches in the use of some functionalities (ex: daylight functionality at Euroclear Bank).

For a trading party, LMFP can usually result mostly from the following reasons:

- Counterparties not using electronic communication means for allocation-confirmation, causing delays in the processing of the instruction;
- Booking issues, such as errors in the quantity or mismatches in the cash amounts;

- Wrong SSI leading to mismatches at CSD level;
- IT issues resulting in transactions blocked in the front-to-back chain before they can be sent to the CSD or custodian;

It should also be noted that post-trade compliance controls may delay the sending of a particular instruction.

For intermediaries, problems will essentially be the same, except that they will not directly have the securities but will expect them from the client, and will suffer from booking or SSI issues at the level of their client and its counterparty.

With regards to "settlement instructions on hold", it should be noted that the Hold function is a pre-matching and risk management tool to allow early matching.

"Settlement instructions on hold" will most of the time correspond to situations where controls managed by the intermediary (ex: balance controls) may not bring a satisfying result.

<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>

Two main operational elements should be considered to improve settlement efficiency.

At the allocation-confirmation level:

Despite the recommendation in CSDR to (1) use standard and electronic means of communication to allocate and confirm and (2) use central databases to communicate SSI soon after trading and well ahead of settlement, and despite further market practices relayed by the participants to their clients and counterparties, such issues as the communication of updated SSI still remain. The regulator may consider to reinforce the recommendation, while considering at the same time that smaller counterparties may incur a significant investment to do so.

At the settlement level:

It is essential that trading parties and CSD participants (1) send their instruction at the CSD as soon as possible in order to be visible by the market and (2) make the most of existing functionalities and services to fluidify settlement, such as:

- Using properly Hold & Release functionalities, that must be generalized at all CSDs, in order to put their instruction on hold if they do not have the required position to settle, and release them when they do.

- Using Partial settlement & Partial releases, which must also be generalized at all CSDs, in order to deliver as much securities as they can to avoid blocking the settlement of other transactions and impact the liquidity of this instrument.

- The use of both functionalities must be generalized at all level of the chain, from the trading party to the CSD participant.
- We would like to remind that where automated partialling is not initially chosen by the parties, and these parties decide *post-ISD* to partially settle some quantities, they should not be penalized by an LMFP as they bilaterally cancel the original instruction to re-instruct partial settlements *[ESMA Q&A – Settlement Discipline Questions 3 – Cash penalties: calculation]*

- Using custodian borrowing and CSD auto-borrowing programs in order to attempt to acquire the required securities when needed.

<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>

Settlement efficiency should be maximized as much as possible, to fluidify the market. But it is not possible to define a particular, appropriate level of efficiency, because it is affected not only by operational inefficiencies and behaviors, but also by elements that are mostly out of the reach of market participants.

Moreover, it is not possible to have one level of settlement efficiency valid all the time. Settlement efficiency will be affected by the trading volumes and the liquidity of a particular instrument that is highly demanded but may be on short supply. Events affecting the corporate life of issuers may also significantly affect the trading of a particular instrument, creating an imbalance between supply and demand that will translate at settlement level and put tensions on settlement efficiency. Finally, external events (like pandemic or wars) will impact markets and accordingly the settlement.

Additionally, it is important to note that all EU markets are different in nature, and have as a result differing settlement volumes and efficiencies:

- Market segments of various liquidity levels may be more developed in one country than in others, resulting in differing overall settlement levels;
- These segments may attract different investors that may be more international;
- These segments may or may not be cleared by a CCP, which will affect the liquidity of the instrument.

This does not mean that we support a differentiation of settlement discipline measure by CSDs, as outlined in our answers below.

<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>

Considering the level of penalty rates today, as mentioned in answers above, and bearing in mind that there may not be enough time since the application of the penalty mechanism to have a full picture, and already state the full benefits the penalty regime will bring, it does not seem that it is sufficiently deterrent for the ultimate failing party.

However, the penalty mechanism should not be the only measure to be regarded, as settlement efficiency is a result of many factors, among which the use of functionalities designed to automate post-trade and fluidify settlement (electronic affirmation-allocation platforms, central SSI databases, hold & release, partial settlement, partial release, borrowing services). Going one step further to ensure a wide use of these services should be closely considered to increase asset velocity.

At the same time, although we are not opposed to higher penalty rates, it is important that they not reach a level that may result in a permanent source of income for market players who are more naturally on the receiving side of penalties as buyers.

<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>

France Post-Marche members do not have such data, that will be more efficiently obtained through CSDs.

<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>

First of all, considering that the volume of settlement fails sharply reduces after ISD+1 or ISD+2 [see chart 15, in TARGET2-Securities Annual Report 2022 (europa.eu) chart 15], the impact of the introduction of progressivity on current settlement efficiency levels may not be as significant and for that reason, is not justified.

But more generally speaking, introducing progressivity in the penalty mechanism raises an important question.

The objective of an evolution of the penalty mechanism should be to rapidly improve the level of settlement efficiency across the chain, while effectively targeting the ultimate failing party.

To this end, any evolution should be based on the following principles:

- It should be easy and quick to implement, and not require a large implementation project at market level;
- It should be simple to explain, to ensure that clients of CSD participants (and upper the chain) understand its purpose, calculation and functioning, including when they are not acting from the EU.
- It should remain neutral for intermediaries, and immunize them from any adverse effect that may result from an imbalance between penalties paid and received – where the fail is for not fault of their own.
- It should have as a target the objective that the cost of fail outweighs the cost of solving the fail, and limit the possibilities of arbitrage.

With these principles in mind, we strongly disagree with progressive penalty rates, for the following reasons:

- It is a complete review of the existing mechanism, which will result in a new project of a size potentially equivalent to the current mechanism, involving all parties (CSD, CCP, participant, clients etc) and a long implementation timeframe, not compatible with an impact quickly visible, and possibly come too late if settlement efficiency improves in the meantime under the existing rules.

- Considering the existing mechanism already required a significant amount of change management to explain its features and processing to clients, progressivity adds significant complexity that may not be understandable enough for clients. As a result, disputes are expected to rise significantly, which will further intensify the effort required to manage the process.
- It puts in question the principle of immunization of intermediaries that the regulator recalled. As an example, a failing party immediately searching to borrow securities, but not finding it on ISD but on ISD+1 may suffer imbalanced penalties if the lender does not deliver on ISD+1.

We consider that the current system contains the essential features to bring more efficiency, provided that it presents a more deterring effect, possibly through higher penalty levels. To this effect, we would suggest a different approach, where penalty rates should be increased above their current level, without the introduction of progressivity.

This approach would ensure a more deterrent mechanism, quickly effective on the market, while remaining proportionate in terms of implementation, and easy to explain at all levels of the chain.
It should also be noted that CSDR already includes a degree of progressivity, with the threat of the entry into force of a buy-in, if penalties do not allow for a satisfying level of settlement efficiency.

<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>

As mentioned in Q22, we consider that the current mechanism in its principles presents the necessary features, provided that the level of penalty rates is reviewed to get more deterrent.
We consider that convexity, similarly to progressivity, adds complexity in a mechanism that should remain simple and easy to explain, not resulting in an increase in disputes that would generate costs. Additionally, together with progressivity, convexity would fundamentally change the existing mechanism, and result in a long implementation project not compatible with the need to see more immediate results.

<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>

See our answer in Q23

<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>

As already mentioned, we disagree with the proposal of progressive rates while agreeing with an increase of the current ones. This being said and with respect to the level of penalty rates, we believe the increase should be significant, to incentivize the timely resolution of the fail, even via the borrowing of securities, and that it should be set at a level where the cost of fail outweighs the cost of resolving the fail.

Yet we believe that it should remain a reasonable increase. The multiplying factors considered in both options are way too high and may well result in unnecessary additional costs that may threaten the competitivity of the European market, and possibly give a reason to settle through facilities not subject to penalties, for instance non-EU CSDs.

Similarly, multiplying factors of up to 25 may create undesirable behaviors from buyers: arbitrage to benefit from penalties, a lack of interest to resolve the fail and trigger existing buy-in mechanisms such as the one designed by ICMA on repo, or even a will not to engage into partialling. On the contrary, the behavior of buyers should be oriented towards all opportunities to resolve the fail.
Finally, the level of penalty rates should also take into consideration that major market turbulence, or major evolutions (such as a move to T+1 settlement cycle) may increase for a time fail rates. In such circumstances, high penalty rates may have an adverse, snowballing, effect on the market.

<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>

First of all, considering the limited hindsight, a first alternative could arguably be to let the current mechanism more time to confirm the actual impact it has on settlement efficiency, isolated from other impacts that may have affected it also – such as the evolution of interest rates or the unwinding of NCB-led purchase programs.

Secondly, an additional alternative could be to give more force to the recommendations on the allocation-confirmation requirements, or make the use of functionalities designed to fluidify settlement more binding, such as the recourse to partialling, when accurate for some transaction types (buy & sell) could for instance become mandatory across the market.

Finally, if higher penalty rates are considered – a simple multiplying factor applied to existing rates without further complexity – we believe that it should be set at a level that makes the cost of fail higher than the cost of resolving the fail, while at the same time keeping the existing differentiation for non-liquid instruments. This notably means that it should outweigh the cost of borrowing securities, although it should be noted that there is currently no unified vision of this cost.

With respect to such increase, that should remain reasonable, we believe that there should be flexibility to review the rate(s) from time to time, either to increase or reduce them, without having to go through the regulation cycle so the impact of the evolution can be felt more rapidly. At present increasing rates requires some time, as the evolution will require to go through the governance of CSDs before it can be implemented. This does not allow for a quick response to adverse market circumstances, where it may be required to act quickly either to decrease or increase penalty rates.
And if a T+1 settlement cycle were to be imposed on the market, considering the resulting effect of higher fail rates and higher penalties, the possibility to suspend the mechanism altogether for a certain period of time should then be considered.

<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>

Generally speaking, we think that, overall, the existing categorization of penalty rates by asset types is relevant, because it allows for sufficient differentiation of instruments with different post-trade processing, and takes into account liquidity considerations. With the exception of the case of ETF, we believe no further granularity is required.

In this respect, we consider the categorization under Option 1 to be relevant, because not only does it stick to the existing categorization, but it also isolates ETF. Today ETF fall under the category OTHER, but it makes sense to consider them separately due to the specificities of this market (primary ETF issuance & secondary ETF trading, absence of a securities lending market), its post-trade processing (notably a lot cross-border), liquidity level, level of settlement fails. On the category ETF, the penalty rate should be proportionate.

The categorization proposed under Option 2 would mean a fundamental review of the existing mechanism which, for reasons mentioned in questions above, is not desirable.

<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	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
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	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

We are not in favor of progressive penalty rates for all the reasons mentioned in previous questions. We believe this would represent not only a major and complex evolution of the existing mechanism, but a full revamp of it as the logic, under both options, fundamentally changes. The cost of such review would fall in the order of magnitude of what the existing mechanism has cost across the market.

<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>

As mentioned, we are not in favor of progressive penalty rates. Besides, we believe the existing mechanism does not require further granularity.

Asset type: the current mechanism already provides for a breakdown by asset type, with enough granularity except for the case of ETF. Again, we support the isolation of ETF as a separate category.

Liquidity: the current mechanism already provides for a breakdown based on liquidity, for equity, but also indirectly for debt instruments (with separate rates for govies usually more liquid, and other bonds usually less liquid). We do not believe further granularity is required.

Type of transaction: we do not support such breakdown for a number of reasons.

- Having different rates depending on the type of transaction is contradictory with the penalty mechanism as initially designed, and its immunization principle.
- Introducing rates that can vary depending on the transaction type will also mean changes in the current penalty mechanism and thus costs and time to be implemented.
- Penalties are applied at the level of the settlement instruction, not the original transaction, which generally speaking does not make the type of transaction a viable criterion.
- The type of transaction is in most cases not identified at the level of the CSD participant, without the participant having the ability to identify whether the categorization is or is not justified.
- When there is a netting, it cannot be identified anymore. Using it would mean that all netting mechanisms should integrate that type of transaction, which would represent a major change.
- To be certain that penalties depending on the type of transaction could be correctly applied, the type of transaction would need to become a matching criterion, which may, as a side effect (beyond the costs of such implementation for CSDs and other actors), increase the level of unmatched transactions and therefore the level of fails.
- In the specific case of securities lending and borrowing, it may be damaging, because securities lending is also a way to ensure the delivery of securities for the purpose of settlement'.

Duration: including a breakdown by duration would amount to introducing a progressivity and possibly convexity as proposed under options 1 and 2, which as previously mentioned, introduces too much complexity and will also impact the neutrality for intermediaries. We believe duration should be considered only as a metric regulators may follow to assess the time needed for the resolution of a fail.

Progressive penalty rates – 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_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>

We are not in favor of progressive penalty rates, and we are not in favor of using the value of the settlement fail either.

The interest of using the settlement value as a base for applying different penalty rates remains unclear, as there is currently no evidence that fails are resolved differently depending on the value of the fail. Besides, there are other reasons which make this option not viable:

- Considering the system should remain simple, introducing this distinction will be difficult to explain to clients and may increase the cases of disputes.
- In the case of partialling (or shaping), every partial settlement may be applied a different rate, implying that the principle of immunization of the intermediaries will be at risk.

- For instance:
- A participant receives 100,000 securities valued at €1mln and will deliver 10*10,000 securities to 10 different counterparties, each for €100k. If he does not receive the securities and can't deliver to its 10 counterparties, and a higher penalty rate applies for instructions below €500k, he will suffer the imbalance.
  - If penalties were higher on instructions with lower value, it may discourage partial settlement, a major tool to fluidify settlement.
  - It also fundamentally changes the current mechanism, and will require a significant and long project, at market level, to implement it.

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	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
Compliance costs: **- One-off** **- On-going**	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

Costs to other stakeholders	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
Indirect costs	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

TYPE YOUR TEXT HERE

<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>

No additional criteria should be considered for the purpose of setting the cash penalty rates.

<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>

We are not in favor of this option.

- The definition of "first day of settlement fail" is unclear: should it be considered as the Intended Settlement Date, or the day when it is first detected?

- This question is also related to issues of market data storage raised earlier in the consultation.
- This would represent a significant modification of the methodology, and is, as such, not desirable.
- If the market value is not daily adjusted, it puts at risk the principle of immunization.

For instance:

- *> A CSD participant has to deliver 100 securities.*
- *> He does not receive them from another counterparty on ISD and tries to borrow them.*
- *> He does not find a lender on ISD, and fails to deliver. A penalty is calculated, valued at the market value of the instrument for the fail on ISD, say €10.*
- *> He finds a lender for 100 securities on ISD+1, for delivery same day, who fails to deliver on time.*
- *> A penalty is calculated for the failing borrow, at the market value at ISD+1, which changed to €9.*
- *> A penalty is also calculated for the failing original instruction, valued with the market value at ISD (€10).*
- *The borrower will receive a penalty that does not compensate for the penalty he will pay on ISD+1 for the original transaction, still valued at €10. He is not immunized of the change in market value on ISD+1.*
- *If the market value of the instrument had changed to €11, he would then unduly benefit on ISD+1 of the change in market value, which is also unfair.*

This may create, opportunities for arbitrage that should be avoided, especially with the high penalty rates proposed.

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	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_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>

Currently, the calculation method for both free of payment instructions and delivery versus payment are aligned. This is the condition to have penalties that are applied uniformly, so there should be no modification in the calculation methodology.

<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>

Currently, the calculation method for both free of payment instructions and delivery versus payment are aligned.
We do not think there is such risk anyway, considering that all participants have an interest in keeping the simultaneity of securities and cash settlement. This simultaneity brings security to the process, and is also the best option from an operational perspective, because it reduces the operational risks involved in separated cash settlement and the processing of FoP which will usually be manual.

<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	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

As of today, there is already a first element of differentiation based on liquidity for debt instruments, with separate categories for sovereign debt and other bonds.

Today, in effect, there is no distinction of the penalties on bonds based on the level of liquidity of the bond, because we understand the information on the level of liquidity is not processed automatically.

We support having reduced penalty rates on illiquid bonds, but this should be based on an automated process:

- The information should be available in FITRS;
- The information should be relayed by market data providers across the chain so they can be exploited automatically by CSDs and by players who recalculate or control the level of the penalties

applied. Using existing distribution channels for this market data will notably ensure transparency in the implementation, which will have a cost anyway.

Additionally, this information on the level of liquidity of a bond, made publicly available and relayed by market data providers is also worthy for the larger market.

<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>

All flexibility considered should abide by the principles laid down earlier in our answers: remain simple, easy to explain, easy and quick to implement, and preserving the principle of immunization of the intermediaries.

As we observe the various options, it appears that only a simple increase in penalty rates can be considered without involving significant implementation costs.

Another option on illiquid instruments would be to sponsor the creation of a securities lending market on illiquid instruments, possibly including clearing by a CCP, which would certainly help solve fails, but which would require confirmed appetite from the market and infrastructures to engage into this.
Alternatively, the regulator may consider excluding from the scope of penalties some bonds highly illiquid, even though they are listed on a trading venue, because adding penalties to an already significant risk of delivery may not be proportionate.

<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>

The risk of non-settlement is overwhelmingly superior to the benefits one can draw out of cash penalties, so counterparties manage their fails. It bears a cost in itself of potentially funding the

securities not delivered, or it may break a chain of transactions, multiplying the effect of the fail across the chain. With regard to buy-side players, it could also threaten their ability to remain within the compliance and investment ratios they have to respect.

Moreover, it should be noted that asset managers should select brokers who offer a good quality of service, including on settlement.
With regards to bilateral cancellation, it should be noted that there are situations when a counterparty of good faith may refuse to bilaterally cancel, not because it benefits from cash penalties, but because in a chain of transactions it may generate financial risks to bilaterally cancel.

<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>

We consider that it would be unfair that the failing party benefits from negative interest parties. At the same time, the solution should not result in significative developments; any solution should remain simple to implement.

<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>

The penalty mechanism must apply across the board, not only to a sub-set of CSDs. Doing otherwise would threaten the principle of level playing field and creates undesirable opportunities for arbitrage.

It would also bring complexity as one would have to consider whether a CSD is subject to penalties or not at the time the trade is negotiated.

Additionally, it would threaten the principle of immunization, as a number of instructions are settled cross-CSD, meaning that the intermediary may be put at a disadvantage.

Finally, it will go against the will of a harmonized settlement in Europe brought by CSDR.

<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	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

We are not in favor of this option.

<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>

As mentioned earlier, we are not in favor of this option, for the following reasons:

- Having different rates depending on the type of transaction is contradictory with the penalty mechanism as initially designed, and its immunization principle.
- Introducing rates that can vary depending on the transaction type will also mean changes in the current penalty mechanism and thus costs and time to be implemented.
- Penalties are applied at the level of the settlement instruction, not the original transaction, which generally speaking does not make the type of transaction a viable criterion.
- The type of transaction is in most cases not identified at the level of the CSD participant without the participant having the ability to identify whether the categorization is or is not justified.
- When there is a netting, it cannot be identified anymore. Using it would mean that all netting mechanisms should integrate that type of transaction, which would represent a major change.
- To be certain that penalties depending on the type of transaction could be correctly applied, the type of transaction would need to become a matching criterion, which may, as a side effect (beyond the costs of such implementation for CSDs and other actors), increase the level of unmatched transactions and therefore the level of fails.

In the specific case of securities lending and borrowing, it may be damaging, because securities lending is also a way to ensure the delivery of securities for the purpose of settlement.

Applying penalty rates by transaction types		
	Qualitative description	**Quantitative description/ Data**
Benefits	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE
Compliance costs: **- One-off**	TYPE YOUR TEXT HERE	TYPE YOUR TEXT HERE

- On-going		
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_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>

First of all, it should be noted that, even though stock borrowing is a very efficient way to fluidify settlement, and while an OTC market exists, securities lending is not a service proposed by all CSDs as most CSDs do not have a banking license, and not all trading parties can engage into it – notably UCITS who are not authorized to borrow securities.

The cost of fail should outweigh the cost of not delivering the securities, and that penalty rates should be set at a level that incentivizes the resolution of the fail, and that there should not be arbitrage between the cost of fail and the cost of borrowing, as exists today. Yet, it should not go up to creating a technical dependance between penalty rates and the cost of stock borrowing. To do so would require a centralized tape of stock borrowing rates, which does not exist today, and would be a major and complex project for the market as a whole, exceeding by far the scope of penalties under CSDR.
In this respect, there should be some correlation between penalty rates and the cost of stock borrowing, and penalty rates could from time to time be revised if the cost of stock borrowing evolves significantly, but there should not be a technical dependance between the two.

<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>

We believe the option to be considered should be a reasonable increase in penalty rates, without progressivity or convexity.

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>

We believe as previously mentioned that markets are very different in nature, in terms of market segments & volumes of instruments traded, infrastructures, origine of investors and post-trade processing, and that they usually do not compare to each other well. This is true of the US market, which presents a structure and post-trade features that are so different from the European markets –

and not unified on the contrary to the US and UK markets - that drawing a comparison will not bring worthy results.

What can be said of all markets, though, is that some functionalities aimed at improving settlement efficiency such as partial settlement, a sane use of hold & release mechanisms and borrowing programs, are in all cases useful tools to fluidify settlement and improve settlement efficiency.
Additionally, there is no official data and measure of settlement efficiency across all European infrastructures.

<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>

As a general rule, CSD participants are purely intermediaries, and where settlement issues are for not fault of their own, they need to remain immune from the impact of penalties. For this reason, they always pass on penalties to their clients, as they are not the ultimately failing party, which is the target of penalties. To this end, penalties must be passed on all along the chain, not only CSD participants to their clients, which may themselves be an intermediary.

In the case of the French market, two exceptions were made to this general rule: instructions from retail clients, and the distribution of funds (transfer agency). In both cases, the penalties involved are not significant.

- For retail clients, it was considered that, because there is a systematic control of the cash and securities balance at the input of the order, settlement issues are never to be blamed on retail clients. For this reason, penalties are not passed on to them.
- With regards to fund distribution, considering that funds in France are settled at the CSD level, possibly listed on a trading venue, they may be subject to penalties. When transfer agents pay penalties for a failing delivery, funds (and so indirectly the investors) are never at fault.

We believe these exceptions should remain, as passing on penalties to these clients would not make sense.

<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>

We observe today that there are numerous penalties of low amount:

- In ESES CSDs, across 2023, 25% of penalties have an amount below €10.
- In Euroclear Bank, across 2023, 24% of penalties have an amount below €10.

At the same time, no correlation can be made between low penalties and the duration of fails. In other words, it is not because a penalty is low, that the failing party is not managing its fails and looking for solutions. As previously mentioned, a settlement fail has a cost which all parties are trying to avoid.

For these reasons, we do not believe there is a necessity for a minimum penalty amount.

But besides, we believe that such option does not respect what we believe are the main principles that need to drive any evolution of the penalty mechanism:

- It would be a significant evolution, and would come at a cost of development, not only at CSDs, but also for all the players who recalculate penalties;
- It could create an imbalance for intermediaries in the case of partial settlements, and thus would conflict with the principle of immunization;
- It would create a distorsion between small orders and large orders, but also between single orders and bloc orders, with an increased cost for small / single orders as compared to others, without economic justification;
- It may have an adverse impact on the use of partial settlement, due to a minimum that may apply to smaller shapes and result in an increased penalty compared to a situation where partialling is not used, which is detrimental to settlement efficiency.

For these reasons, we are not in favor of a minimum penalty amount.

<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>

The time required would very much depend on the nature of the evolution.

A major change could require up to 4 years, considering that a change in T2S requires 2-3 years minimum.

For smaller changes, at the level of CSD participants or trading parties, any change is subject to budget adoption in summer of year N-1 to start developments in year N, meaning no implementation can be considered for them before year N+1.

If the change is limited to an evolution of the penalty rates without further complexity, it could take around 6 months considering it has to go through the governance of all CSDs.
It should also be noted that the current regulatory workplan is heavily loaded, with a number of changes required from banks and financial institutions at a time when budgets are very constrained. Any evolution of the penalty mechanism, in order to be implemented quickly, would need to be very simple in terms of implementation, and at a limited cost. More significant evolutions would need to be carefully prioritized over other regulatory changes.

<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>

This piece of information is not publicly disclosed and cannot be commented by our association.

<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>

We do not believe such special penalties would be justified.

For an intermediary, such penalties would not be justified. Considering he is acting on behalf of others, as long as settlement instructions are sent to the CSD as soon as possible for matching, and cash and securities balances are controlled, imposing special penalties will not help penalizing the ultimately failing party. Moreover, such special penalties cannot be recharged to the clients, which would conflict with the principle of immunization of the intermediaries.

For a CSD participant that is a trading party acting on its own account, the same reasoning can be applied. Securities are bought and sold, borrowed and lent, meaning that most of the time, a lack of securities will be caused by a counterparty failing to deliver in another transaction, or liquidity issues on the instrument that can have a number of reasons outside of the reach of the financial institution (related to market events for instance). Imposing special penalties to them would not have justification, because they may not be the ultimately failing party.

<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>

France Post-Marche members do not have the ability to answer this question.

<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>

In France, settlement efficiency has been discussed on the market well before the entry into force of the settlement discipline: several associations and working groups have been monitoring the evolution of fail rates since before 2010, and settlement efficiency is being discussed at the CSD User committee.

Over the years, this monitoring has triggered numerous discussions on the opportunity to improve settlement efficiency, and resulted in a number of market practices specifically aimed at improving settlement efficiency, for instance:

- Reinforcement of allocation-confirmation requirements;
- Use of UNT-FAMT indicator;
- Use of partial settlement indicators, and partial release.

A dedicated workgroup on settlement efficiency considers on a continuous basis the need for additional market practices.
To support this monitoring, ESES CSDs and LCH SA circulate on a regular basis settlement fail statistics (on a monthly or quarterly basis depending on the frequency of the instance).

<ESMA_QUESTION_CSDR_51>