9 July 2024
ESMA74-2119945925-2037

Reply Form

to the Consultation Paper on Technical Advice on the Scope of CSDR Settlement Discipline

Responding to this Consultation Paper

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

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

ESMA will consider all comments received by **9 September 2024.**

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

Instructions

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

- Insert your responses to the questions in the Consultation Paper in this reply form.
- Please do not remove tags of the type < ESMA_QUESTION_SETD_0>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
- When you have drafted your responses, save the reply form according to the following convention: ESMA_CP1_ SETD_nameofrespondent.

  For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA_CP1_ SETD_ABCD.
- Upload the Word reply form containing your responses to ESMA's website (**pdf documents will not be considered except for annexes**). All contributions should be submitted online at *www.esma.europa.eu* under the heading *'Your input - Consultations'.*

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Data protection'.

Who should read this paper?

All interested stakeholders are invited to respond to this consultation paper. In particular, ESMA invites market infrastructures (CSDs, CCPs, trading venues), their members and participants, other investment firms, credit institutions, issuers, fund managers, retail and wholesale investors, and their representatives to provide their views to the questions asked in this paper.

1 General information about respondent

Name of the company / organisation	International Capital Market Association (ICMA)
Activity	Other
Are you representing an association?	☒
Country / Region	International

2 Questions

Q1 Do you agree with ESMA's proposal regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions? Please specify which cases you agree with and which cases you don't agree with (if applicable). Please justify your answer and provide examples and data where available.

<ESMA_QUESTION_SETD_1>

In terms of general comments, ICMA would like to highlight the following:

- As a general rule, ICMA believes that **exemptions from CSDR cash penalties should be limited**. This goes back to the economic justification of a penalty mechanism, which relates to the natural cost of failing and behavioural incentives for timely settlement. Moreover, given the interconnectedness in the system across various transaction types and other operations, exemptions potentially challenge the principle of immunisation, as described by ESMA in the CP. In this respect, it is important to ensure that intermediaries caught in a chain of fails are not penalised (ie that they are 'flat' in terms of penalties paid and received).
- We also agree with ESMA that the ease with which exemptions can be applied should be a consideration. There is a **clear preference for any exemptions to be applied ex-ante** directly by the CSD. Any ex-post application will involve manual intervention and will often involve a costly and cumbersome appeals process. In order to ensure that the appeals process, where needed, works as smoothly and efficiently as possible and avoid overburdening CSDs, scenarios that require resolution through appeals should be reserved for exceptional circumstances, also considering that the timeline for the appeals process is already very tight.

- Having said that, both of those general points do not negate the need/justification for any exemptions, but they are important considerations that need to be weighed carefully against the arguments in favour of any exemption.
- We note that the ESMA CP aims to establish a **single approach across all settlement discipline measures**, including fails reporting, cash penalties and mandatory buy-ins (MBI). While we understand that this is mainly due to the way the CSDR Level 1 text and the related ESMA mandate is drafted, we would reiterate the need to carefully distinguish between the different settlement discipline measures when it comes to the scope, particularly between cash penalties and MBIs, as the logic is fundamentally different. For example, the immunisation principle is only of limited relevance in the context of MBIs. Similarly, as the counterparties are responsible for triggering buy-ins (not the CSD), considerations around the automatic/ex-ante determination of the scope is far less relevant. Counterparties will know if a certain transaction is in scope of MBIs, but this does not need to be communicated to a market infrastructure, so, as long as the rules are clear, this would not create any issue. In this light and also considering their potentially highly disruptive impact, there is a need to consider more far-reaching exemptions from MBI provisions (beyond those already specified in Level 1). Our comments in this response should therefore be read as applying solely to cash penalties. The scope for MBIs should be consulted on separately.

More specifically, as regards the ESMA proposals in paragraphs 17-18, ICMA generally supports the exemptions proposed by ESMA as *causes of settlement fails that are considered as not attributable to the participants in the transaction.*

- While all of the 6 cases outlined by ESMA make sense, we would point out that it will be important to apply those consistently and this may require some system changes. For example, when it comes to scope, CSDs will often rely on information in "golden sources" such as **ESMA's FIRDS database**. In the case of a suspension from trading, for example, it might not be straightforward to reflect this immediately (and consistently across trading venues) in the FIRDS database The application of this exemption will therefore be dependent on the way the FIRDS system operates.

<ESMA_QUESTION_SETD_1>

Q2 **ESMA would like to ask for the stakeholders' views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions). Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.**

ESMA's proposal - underlying causes of settlement fails that are considered as not attributable to the participants in the transactions		
	Qualitative description	**Quantitative description/ Data**
Benefits		
Compliance costs: **- One-off** **- On-going**		
Costs to other stakeholders		
Indirect costs		

<ESMA_QUESTION_SETD_2>

Benefits:

- One clear benefit of formalising the exemptions would be the added legal certainty for market participants. This is especially obvious for those exemptions that are already in place today either through Q&As or industry best practice (particularly the ECSDA penalty framework).
- Where exemptions can be applied ex-ante this would also reduce the number (and cost) of manual appeals.

Cost:

- As pointed out by ESMA, there will likely be a cost involved to develop systems to automatically apply exemptions at CSD level, but this should be limited relative to the benefits of such an approach pointed out above.
- In the case of exemptions that cannot be applied ex-ante, the cost would come in the form of additional (manual) appeals as well as the associated risk of overburdening the current process and causing delays.

<ESMA_QUESTION_SETD_2>

Q3 Do you have other suggestions regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the

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

<ESMA_QUESTION_SETD_3>

- In case of trading of securities that involve a conversion from RegS bonds into 144A bonds (and vice versa), there might be delays in the conversion process in terms of ISIN allocation which are outside of the control of the trading parties.

- From a **primary market perspective**, ICMA has previously stated (see pp.33-34 of ICMA's 29 February 2024 response to ESMA):

  (a) there may be frequent settlement fails related to new issuances due to inconsistent settlement deadlines across time zones that are not attributable to the transaction participants and/or regarding transactions involving non-trading parties; and consequently

  (b) all transactions in a new bond (whether in the primary market or in the secondary market), which are due to settle on that bond's new issue closing date, should not be subject to cash penalties, provided they settle by the next following CSD business day (i.e. a one-day 'grace period').

- ESMA seems to be looking at primary market dynamics only in the context of transactions involving non-trading parties. It is not clear why this should be so, but ICMA sets out its detailed points in that context solely to avoid duplication and such points should be read across to this context also.

<ESMA_QUESTION_SETD_3>

Q4 **If you have answered yes to the previous question, please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.**

Respondent's proposal (if applicable)		
	Qualitative description	**Quantitative description/ Data**
Benefits		
Compliance costs: **- One-off**		

- On-going		
Costs to other stakeholders		
Indirect costs		

<ESMA_QUESTION_SETD_4>

See our response to Q11 for our comments related to the 'grace period' proposal.

<ESMA_QUESTION_SETD_4>

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

<ESMA_QUESTION_SETD_5>

- We suspect that there may be instances where the application of some of the proposed exemptions could breach the immunisation principle, particularly in the case of trades that involve **cross-CSD settlement**. Where more than one CSD is involved in the settlement process there is scope for divergence in terms of interpreting/applying the exemptions above. This risk is probably most relevant for: suspensions from settlement (point a), technical impossibility at the CSD level (where only one CSD is affected) (point d), as well as differences in the interpretation of sanctions (point i) or police/court orders (point ii). In a few cases, breaches might also occur for intra-CSD settlement, eg in the case of police/court orders that only reach a subset of participants in that CSD.
- That said, these instances are expected to be **very rare and should be manageable as exceptions**. There are already industry best practices related to claims which could be applied in this context to re-establish the immunisation principle where one of the parties has been unfairly penalised. We would also re-iterate, as ESMA points out, that points a) to d) above should already apply today (in the form of Q&As). We are not aware whether or not this has already caused any breaches of the immunisation principle, but given the absence of any related queries we would assume that this has not been a problem so far and is unlikely to become a significant issue going forward.

<ESMA_QUESTION_SETD_5>

Q6 **Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which ones can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs?**

Please provide details regarding the cost for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

<ESMA_QUESTION_SETD_6>

We understand that in most cases CSDs should be able to apply the exemptions set out by ESMA automatically and on an ex-ante basis.

There will be some **exceptions** where such automation is more difficult to achieve, particularly the proposed case (ii) as CSDs would likely not be aware of any recent court/police orders. Suspensions from trading (given the dependency on the FIRDS database explained above) and sanctions may also be challenging for the CSD to apply ex-ante. (Some of) those cases would likely have to be resolved through the appeals process, but as mentioned above, this should be manageable given that such cases are expected to be rare.
<ESMA_QUESTION_SETD_6>

Q7 **For exemptions that can be filtered out in advance, do you think that a CSD would prefer to implement this filter or not? Also considering the very large number of appeals they might have to deal with and also the costs it will entail.**

<ESMA_QUESTION_SETD_7>

From a market participant's perspective, there is a **clear preference for applying any exemptions ex-ante**, wherever this is feasible. The potential benefits in terms of the efficiency of the process will likely outweigh the cost of automating this process at the CSD, which is expected to be limited.
<ESMA_QUESTION_SETD_7>

Q8 **Do you agree with ESMA's proposal regarding the circumstances in which operations are not considered as trading? Please specify which cases you agree with and which cases you don't agree with (if applicable). Please justify your answer and provide examples and data where available.**

<ESMA_QUESTION_SETD_8>

In terms of general comments on this section, ICMA would like to highlight the following:

- In terms of circumstances in which operations are not considered as trading, as ESMA notes, this can be a subjective assessment which depends on the intention of the parties. In order to avoid unnecessary inconsistency and breaches of the immunisation principle, we would again argue for a **narrow approach with very clear definitions and rationale** for any exemption from cash penalties.
- While there are valid reasons for exemptions under certain circumstances, we would question whether all operations that are not strictly considered as trading should automatically be exempted from penalties. Even for certain securities transfers that are not the result of trading decisions there is a need for timely settlement and potentially an inter-dependency with other settlements (including those resulting from trading), as the latter may be contingent on those securities transfers. Hence, every exemption should be carefully considered in this light.

More specifically regarding the ESMA proposals in paragraph 19, ICMA generally supports the five exemptions proposed by ESMA in terms of *circumstances in which operations are not considered as trading*, although some of them will have to be more clearly defined and/or narrowed down. In particular, we note:

- Point a): ESMA notes in the CP that this point was proposed by the ECB. We assume that this refers specifically to certain ECB operations (and not collateral movements more broadly). This should be made more explicit. The ECB should be asked to provide a more specific definition, including in terms of the applicable transaction type.
- Point e): Realignment operations need to be more clearly defined. In our view this could be limited to movements between CSD mirror accounts, such as “technical T2S realignments” as defined by T2S. We note that the latter are already exempted today from penalties as per the T2S penalty mechanism designed and reflected in the ECSDA Penalties Framework which is being applied by all CSDs. It would be useful to formalise this approach in Level 2. Exempting other realignments (in a broader sense) may avoid some “noise” in terms of penalty calculation, but the implementation cost would likely outweigh those benefits, considering that this should not result in any “unfair” outcomes.

Furthermore, from a **primary market perspective**, we note that point c) above covers a specific aspect of the new issuance process, but it does not sufficiently address the concerns that ICMA has previously raised:

1. ICMA has previously stated (see pp.33-34 of ICMA’s 29 February 2024 response to ESMA):
   a. there may be frequent settlement fails related to new issuances due to inconsistent settlement deadlines across time zones that are not attributable to the transaction participants and/or regarding transactions involving non-trading parties (see detail in #2-3 below below); and consequently

b. all transactions in a new bond (whether in the primary market or in the secondary market), which are due to settle on that bond's new issue closing date, should not be subject to cash penalties, provided they settle by the next following CSD business day (i.e. a one-day 'grace period').

2. Recapping the February response, this case arises where a new bond issue is initially delivered by the issuer into DTCC in the United States, for the new issue underwriters (the delivering trading parties) to settle with the initial primary market investors (the receiving trading parties) in the two international CSDs (ICSDs / Euroclear and Clearstream) in Europe. Such initial delivery by the issuer occurs in the morning in the United States but also then in the afternoon in Europe, due to time zone differences. So onward transfer from DTCC into the ICSDs by the underwriters quite commonly misses the ICSDs' intra-day cut off times for same-day ('daylight') settlement. This has been a long running situation that was not historically perceived as problematic, since the ICSDs back-value next-day ('overnight') settlement receipt by the initial primary market investors (enabling timely payment of the issue proceeds to the issuer). In this respect the initial same-day settlement failure typically relates to the delivery from a new issue underwriter's DTCC account to another new issue underwriter's ICSD account (as a preliminary to delivery to primary market investors' ICSD accounts) and is thus both (i) not attributable to the transaction participants (being due to initial issuer delivery in a United States time zone) and (ii) typically regarding transactions involving non-trading parties (as involving just new issue underwriter accounts rather than new issue underwriter accounts and primary market investor accounts).

3. The February response noted that, in this respect, it was anecdotally reported to ICMA that primary market investors were being asked in some cases to accept their initial allocation in their DTCC accounts. Primary market investors can then, if they wish, transfer their bonds from their DTCC accounts to their own ICSD accounts as a secondary delivery – with any fails etc being internal to each primary market investor and less impacted by the ICSDs' cut-off times. It was also suggested, as an alternative, that initial delivery by the issuer occurs directly into the ICSDs – though the likelihood of practical traction with issuers used to delivery into DTCC (in terms of adopting a new procedure in a different time zone) still remains to be seen.

4. The February response also noted that the need for such a solution seems likely to grow in importance to the extent the currently relatively low penalty rates for bonds may increase, particularly on the scale proposed by ESMA.

5. ICMA notes ESMA seems to be looking to provide an alleviation for settlements related to new issuances in proposing that *"the process of technical creation of securities, meaning the transfer from the CSD's issuance account to the issuer's CSD account"* not be subject to cash penalties. However:

a. it is not clear that this complies with the immunisation principle referenced in #12 of this consultation (unlike ICMA's 'day one' proposal), since the consequently delayed subsequent settlement of any on-sale trade would be penalised (unfairly) – particularly given the emphasis in #20 of this consultation that ESMA does not think that "a failed delivery on a market sale transaction caused by the delay in issuing the instrument on the primary market […] should be considered as excluded from the application of [*the*] cash penalties […] regime";
b. this seems to assume a strictly single-CSD, and potentially locally-fragmented, approach to primary issuance rather than a truly cross-border one that involves 'bridges' between CSDs (with creation occurring in one CSD for credit into another CSD);
c. it is not clear how this will map into the international market context of the two ICSDs (Euroclear and Clearstream) where no "issuer's CSD account" is involved (initial creation occurring either in a 'commissionaire' account or in the issuer agent account), though ESMA's intention is presumably not to discriminate against the ICSDs (with a *mutatis mutandis* interpretation being applicable in this respect).

6. ICMA consequently reiterates its proposed solution in #1b above.

<ESMA_QUESTION_SETD_8>

Q9 ESMA would like to ask for the stakeholders' views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the circumstances in which operations are not considered as trading). Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

ESMA's proposal - circumstances in which operations are not considered as trading		
	Qualitative description	**Quantitative description/ Data**
Benefits		
Compliance costs: **- One-off** **- On-going**		

Costs to other stakeholders		
Indirect costs		

<ESMA_QUESTION_SETD_9>

The same cost and benefit considerations apply as described in our response to Q2. However, the costs are likely exacerbated by issues related to the inconsistent use of the transaction identifier field, as further explained in Q15.

See our response to question 11 for cost/benefit considerations related to ICMA's proposed 'grace period'.
<ESMA_QUESTION_SETD_9>

Q10 Do you have other suggestions regarding circumstances in which operations are not considered as trading? Please justify your answer and provide examples and data where available.

<ESMA_QUESTION_SETD_10>

See ICMA's proposed 'grace period' solution noted under Question 8.

From a secondary market perspective, we do not have any other suggestions.
<ESMA_QUESTION_SETD_10>

Q11 If you have answered yes to the previous question, please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

Respondent's proposal (if applicable)		
	Qualitative description	**Quantitative description/ Data**
Benefits		
Compliance costs: **- One-off** **- On-going**		

Costs to other stakeholders		
Indirect costs		

<ESMA_QUESTION_SETD_11>

From a **primary market perspective**, and in relation to the 'grace period' proposal explained above we note the following:

The benefit of ICMA's proposed 'grace period' solution noted under Question 8 will be a **lowering of unfairly levied penalties**, particularly to the extent the currently relatively low penalty rates for bonds may increase and this on the scale proposed by ESMA. (And no parties would be left consequently exposed.). The only costs involved would seem to relate to the CSDs needing to recalibrate their existing penalty processes (which they would be doing to a certain extent anyway further to these CSDR reforms) and which should **hopefully be relatively minor**: (i) no transaction classification (as referenced in #13 of this consultation) is needed since settlement dates are the only relevant parameters and (ii) the solution would apply on an ex-ante filtering out basis, rather than ex-post appeal, basis (as referenced in #16 of this consultation).

<ESMA_QUESTION_SETD_11>

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

<ESMA_QUESTION_SETD_12>

In relation to point c) proposed by ESMA, as explained in our response to question 8 (see #5a), it cannot be excluded that this would breach the immunisation principle, unlike ICMA's 'grace period' explained above which would be neutral in this regard.

<ESMA_QUESTION_SETD_12>

Q13 Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which one can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs?

Please provide details regarding the cost for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

<ESMA_QUESTION_SETD_13>

As explained in our response to Q11 above, the proposed 'grace period' should hopefully be **relatively minor for CSDs to apply** on an automated/ex-post basis, subject to some system developments.

<ESMA_QUESTION_SETD_13>

Q14 For exemptions that can be filtered out in advance, do you think that a CSD would prefer to implement this filter or not? Also considering the very large number of appeals they might have to deal with and also the costs it will entail.

<ESMA_QUESTION_SETD_14>

CSDs being generally neutral in the cash penalty process, one might imagine a general preference for no change to existing processes as involving no cost. But ICMA's proposed 'grace period' solution noted under Question 8 would (as noted under Question 11) involve less burdensome ex-ante filtering out with no and no ex-post appeals being needed.

<ESMA_QUESTION_SETD_14>

Q15 Which transaction types based on the codes allowed by T2S (or potentially other codes such as ISO transaction codes) should be exempted from settlement discipline measures? Please provide the codes, their definition and arguments to justify the exemption.

<ESMA_QUESTION_SETD_15>

- Using the transaction type identifier as a basis to identify exemptions does make sense in principle. However, there is one significant caveat, which is that the relevant field (:22F) in settlement instructions is **not used systematically by market participants**. Under CSDR the field is already mandatory, but we understand that (i) its use is not currently

harmonised across CSDs and (ii) there is no consistent market practice for participants to use the field. This is an issue that ICMA and the ERCC specifically have highlighted in the past as it also means that currently SFTs are not systematically distinguished from outright (cash) trades at settlement level. This has implications in terms of transparency, but also prevents further automation of repo coupon payments ('manufactured payments').

- Requiring CSDs to make the transaction type identifier field available to participants in a consistent way would be a useful starting point. And using the field as a basis for the application of (automatic) exemptions from cash penalties may provide an incentive for market participants to use the field more consistently, as we understand that any exemption could only be applied if both counterparties fill in the field correctly, ie if the transaction code matches.
- A more far-reaching alternative, which would also address the repo specific issues mentioned above, would be to make the relevant transaction type identifier a mandatory matching field at CSD level (rather than only a mandatory field). While this would have the benefits described above, such a step would have to be carefully considered as it may lead to matching breaks (and potentially settlement fails), especially in the absence of consistent guidance on how to populate the field.

<ESMA_QUESTION_SETD_15>