DRAFT - ECSDA SINGLE SETTLEMENT FAILS PENALTIES FRAMEWORK

FOR THE PURPOSE OF THE HARMONISED APPLICATION OF THE CSDR SETTLEMENT DISCIPLINE REGIME

Contents

GLOSSARY

Acronym or abbreviation	Description
BD	Business day(s)
CA	Competent Authority(ies); relevant supervisor(s)/ regulator(s) of the CSD
CCP	Central Counterparty
CSD	Central Securities Depository
CSDR	REGULATION (EU) No 909/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 ("EU CSD-Regulation") https://www.esma.europa.eu/regulation/post-trading/settlement
DR	EU Delegated Regulation; in relation to penalty reference prices and applicable rates see http://eur-lex.europa.eu/eli/reg_del/2017/389/oj
ECB	European Central Bank
ESMA	European Securities and Markets Authority
ICSD	International Central Securities Depository (Clearstream Banking Luxembourg or Euroclear Bank); note that CSDR is applicable for both, CSDs and ICSDs
ISD	Intended Settlement Date; date on which the settlement instruction shall/ should have settled (same meaning as "Requested Settlement Date (RSD)"in Clearstream terminology)
MiFID/ MiFIR	DIRECTIVE 2014/65/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 [Markets in Financial Instrument Directive II] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065&from=EN REGULATION (EU) No 600/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 [Markets in Financial Instrument Regulation] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0600&from=en
SDR	CSD-R Settlement Discipline Regime; amongst others, prescribing CSD settlement functionalities, measures to prevent settlement fails (incl.

Acronym or abbreviation	Description
	penalties, mandatory buy-ins and sanctions to participants) and reporting to be provided. The standards describing the regime in detail can be found here: https://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-3097-F1-EN-MAIN-PART-1.PDF
SFD	EU Settlement Finality Directive http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1998:166:0045:0050:EN:PDF
SSR	REGULATION (EU) No 236/2012 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 March 2012 [Short Selling regulation] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0236&from=EN
T2S	Target 2 Securities; European Central Bank (ECB) centralised settlement platform
T2S CSDR TF	Task Force composed of representatives from ECB, Central Banks, CSDs, ECSDA and the Banking community to discuss requirements towards and solutions of T2S related to CSDR

INTRODUCTION

On 23 July 2014, the European Parliament and the Council have issued the new Regulation (EU) No 909/2014 (later, CSDR[1]) aiming at harmonisation of the regulatory environment of the securities settlement and Central Securities Depositories in the Union. In the effort of compliance with the Regulation, European CSDs also take into account the regulatory and contextual elements having lead the CSDs to develop the present ECSDA Settlement Fails Penalties Framework (later, the ECSDA Framework) as described below.

(i.) This document recognises the importance of the provisions of articles 6 & 7 (with regard to measures to prevent and measures to address settlement fails") of the CSDR, as well as its final delegated acts describing the Settlement Discipline Regime, SDR)[2]. The provisions aim at increasing settlement efficiency and harmonising settlement discipline measures across the Union through the following four key pillars:

Pillar I.   Measures to prevent settlement fails:

- Trade allocations and confirmations (obligation for Investment Firms, not applicable to CSDs);

- Automation of CSDs´ settlement processes and reporting of "manual interventions";

- Settlement instructions mandatory matching fields;

- CSDs´ settlement functionalities aiming at preventing settlement fails (e.g. bilateral cancellation, hold & release, partial settlement) and possible derogation from the requirements to develop some of these functionalities by smaller CSDs.

Pillar II.   Requirements to monitor and report settlement fails:

- CSDs are required to monitor and analyse settlement fails and CSD participants´ settlement efficiency, including setting up working groups to define measures to improve efficiency;

- Settlement efficiency/ fails reporting to authorities, CCPs/ Trading Venues and public.

Pillar III.   Requirements for CSDs to charge cash penalties to users that cause settlement fails (subject of the present ECSDA CSDR Framework):

- For matched settlement instructions failing to settle on the Intended Settlement Date (ISD), a daily calculation, (at least) monthly collection, distribution and

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[1] https://www.esma.europa.eu/regulation/post-trading/settlement
[2] As proposed by the European Commission on 25 May 2018 and published here:
https://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-3097-F1-EN-MAIN-PART-1.PDF

reporting of penalties to CSD participants are required to be developed by CSDs subject to CSDR or alike regulation.

Pillar IV.   Rules requiring a mandatory buy-in:

- Trading parties are required to initiate a mandatory buy-in after a specific period of time after the ISD (CSD role limited to information gathering and regulatory reporting).

(ii.)   The CSDR foresees a deferred implementation of 24 months following the day of their publication in the Official Journal of the European Union.

(iii.) Pursuant to delegated acts, ESMA will issue additional guidelines which would be taken into account in the final version of the ECSDA framework.

(iv.) The parameters for the calculation of cash penalties for settlement fails have been adopted and officially published in March 2017 ("Cash Penalties Calculation Delegated Act"; see chapter 5 of this Framework document for details).

(v.)   Based on the draft delegated acts available by the time, T2S CSDs and Eurosystem have initiated discussions in order to comply with ESMA SDR RTS Art. 19 *"CSDs that use a common settlement infrastructure* [e.g. T2S], *(...) shall jointly manage the calculation, application, collection and redistribution of cash penalties. They shall establish the modalities for that calculation, application, collection and redistribution in accordance with Regulation (EU) No 909/2014* [CSDR]." A dedicated T2S CSDR Task Force (later, T2S CSDR TF) was established in March 2016. It included representatives of CSDs, CSD participants and CCPs, aiming to identify the necessary changes to the T2S platform and to facilitate T2S CSDs' timely compliance with CSDR.

As a result, the following documents were drafted (see Annex for details):

- T2S penalty mechanism document (and subsequent specifications of the T2S Change Request 654)

- Penalty lists – Draft message overview

- List of clarifications sent to ESMA

T2S Change Request 654 was raised and is planned for implementation in 2020. However, the actual implementation date depends on the actual date of the entry into force of the relevant CSDR delegated acts. Please note that a number of penalties-related elements mentioned in this Framework have been explicitly excluded from the T2S CSDR Task Force discussions and the documents resulting from it, such as:

i.   Agreement on the list of financial instruments subject to penalties and feed of a "golden data source" for the purposes of cash penalties calculation;

ii.   CSD reconciliation, including the reconciliation mechanisms and principles when two penalty systems calculate a different cash penalty for a transaction (e.g. in case of a cross-CSD settlement with one of the CSDs not using T2S);

iii. Collection and redistribution of cash penalties (i.e. the actual payment of cash penalties);
iv. Reporting and messaging from CSDs to their participants or between CSDs;
v. Interaction with the buy-in process;
vi. Reporting to competent authorities.

1   ECSDA CSDR PENALTIES FRAMEWORK KEY CONSIDERATIONS

1.1 The ECSDA Framework should be applicable to all (I)CSDs subject to the CSDR.

1.2 The Framework aims at ensuring that all (I)CSDs implement the provisions in a harmonised way, neutral of whether settlement takes place in- or outside of T2S and neutral to the systems that will be used by (I)CSDs to process settlement fails penalties.

1.3 CSDs having signed the T2S Framework Agreement are required to "jointly establish the penalty mechanism referred to in Article 7(2) of Regulation (EU) No 909/2014 and jointly manage the modalities for the calculation, application, collection and distribution of cash penalties in accordance with this Regulation"[3]. For this purpose, as well as for the purposes of information exchange on cash penalties for reconciliation and collection and distribution of cash penalties in a cross-CSD scenario, the ECSDA Framework constitutes a document expected to be binding to the CSDs having approved it through the ECSDA Board and having declared their adherence to the framework.

1.4 ESMA and T2S documents served as basis for creating this Framework and large parts of the Framework are fully aligned and have been sourced from the discussions at the CSDR Task force as mentioned in "T2S Penalty Mechanism" document (version October 2017).

1.5 For the purposes of compliance with article 20 of the CSDR SDR mentioned in point 1.3, this Framework also covers the aspects that are not subject to the T2S CSDR Task Force documents (as they are not covered by the T2S scope as noted in the introduction).

1.6 This document may be subject to changes due to various working assumptions taken due to pending ESMA feedback.

1.7 Once agreed by the Board of ECSDA in its draft version, the Framework was decided to be shared with other stakeholders (i.e. (I)CSD participants, ECB, Central Counterparties, ESMA and other European Union and National authorities) with the aim of alignment and information sharing with relevant stakeholders.

1.8 According to CSDR and final ESMA RTS, the following principles must be applied by all EU (I)CSDs:

  a. A (I)CSD should provide for a cash penalty mechanism for participants that caused settlement fails.

  b. ASSUMPTION (ESMA to confirm): All failed settlement instructions are subject to penalties unless regularly or temporarily exempted.

  c. Cash penalties are to be calculated on a daily basis for each business day that a matched (free of or against payment) settlement instruction fails to settle after its Intended

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[3] CSDR SDR RTS Article 20.

Settlement Date (ISD), including those instructions that are on hold (gross basis) or are failing due to a lack of cash.

d. Penalties should also apply to settlement instructions entered into or matched in the securities settlement system after their ISD.

e. Cash penalties are calculated as from the ISD until the actual settlement date, considering[4]:

1) Late Matching Fail Penalty: penalties apply from the ISD until the matching date

2) Settlement Fail Penalty: penalties apply from the matching date to the actual settlement date.

Note: Both, a late matching fail penalty and a settlement fail penalty, can apply on a single instruction. However, they cannot be both charged for the same business day. For a single business day, only one of the two would apply: either a late matching fail penalty or a settlement fail penalty, depending on the matching timestamp (before or after the cut-off).

f. Daily reports should be provided to the (I)CSD participants in order to allow them to reconcile and calculate the recharge of the penalty to their underlying clients where applicable.

g. The (I)CSD must distribute the penalties only once they have collected them.

h. The full amount collected as a penalty should be redistributed to the participant that suffered from the fail at least on a monthly basis.

i. CCP-instructions: (I)CSD must calculate and report penalties for participants that are CCPs but not actually collect/ distribute any penalties; (I)CSDs must ensure that CCPs collect and redistribute fails penalties from/ to the relevant clearing members and provide a monthly report to the (I)CSDs.

j. The cash penalties should not be configured as a revenue source for the (I)CSD[5].

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[4] There is no overlap between a SEFP and a LMFP. For a given business day, only one type of penalty is calculated.

[5] However, CSDs have the possibility to charge for the cost of development and maintenance of their penalty system as a fee separate from the actual penalties amounts.

2   PENALTIES LIFECYCLE AND BUSINESS DAYS CALENDAR

This chapter covers:

A. Daily events:
    i.   Penalties calculations
    ii.   Reporting
B. Monthly events:
    i.   Reporting
    ii.   Appeal period
    iii. Penalties aggregation
    iv. Collection and re-distribution (Payments)

Daily and monthly events are to be scheduled for the business days defined below.

2.1   BUSINESS DAYS

Applicable business days calendar:

- For intra-CSD transactions, the CSD´s own settlement calendar should be used.

- For cross-border transactions, in addition to the CSD´s own settlement calendar, the other CSD´s or Payment System calendar should be used.

Business days are those days on which an instruction can settle in the own CSD <u>and</u> (in a cross-CSD context) the other CSD´s or Payment System ("opening days").

In order to allow CSDs to be able to assess the relevant European CSD´s opening days for securities and cash processing, the relevant information should be provided to ECSDA and be made available to CSDs centrally via ECSDA.

ASSUMPTION (ESMA to confirm): A penalty <u>should not be calculated</u> for the days where one of the CSDs has been reported as closed or a settlement instruction <u>cannot settle</u> in one of the involved CSDs´ systems.

2.2   DAILY CALCULATIONS

A CSD should be able to calculate the daily penalties after completion of the last settlement cycle of the CSD´s business day.

The CSD will calculate net penalties per counterparty on a daily basis. This can only be completed once all the possible daily penalties (re-)calculations and cancellations have been completed.

Daily penalties calculation for the settlement instructions and daily calculation of the net penalties per counterparty should be completed by the CSD as soon as possible to make the daily reports available to its participants (including other CSDs) in a timely manner.

Daily penalties, previously calculated by the CSD for the current calendar month, can be changed (i.e. re-calculated due to changes in applicable reference data or through valid appeals) or removed (i.e. cancelled) on any business day until the appeal period has ended on the 11th business day of the

following month. Daily penalties previously removed by the CSD for the current calendar month can be re-calculated if applicable reference data has changed or through valid appeals and re-included on any business day until the appeal period has ended on the 11th business day of the following month.

The penalties calculation rules (for both, daily penalties and daily penalties netted by counterparty), as well as the reference data used in the calculations are described in chapter 7 "Calculation methods of the cash penalties".

2.3 DAILY REPORTING

CSDs will send a daily penalty report to their participants when there are new, amended or removed penalties during the day.

CSDs should generate one Cash penalties report per business day, including any amended penalties (if applicable; if changes impact different business days, one report per business day will have to be created, providing the new bilateral net amount per counterparty).

In the (unlikely) case of no transaction resulted in penalties applied for one reporting day, a report stating "no activity" should be sent[6].

CSDs should deliver the daily reports to their participants and involved CSDs after the closing of the settlement day (on which the penalties were calculated, cancelled or re-included) and latest until noon (12.00 p.m. CET) on the following day, regardless of whether the next day is a business day.

ASSUMPTION (ESMA to confirm): In cross-CSDs settlement scenarios, if all involved CSDs are subject to CSDR, the involved CSDs will perform the calculations and report them amongst each other. I.e. the CSDs will receive daily penalties report(s) from one or more CSD(s) that they should reconcile with the penalty amounts to be received by/ paid to their participants as calculated in the CSDs´ own systems (theoretically for the same amount) and subsequently reported to its CSD participants (please refer to chapter 9 "Cross-CSD settlement fails").

The penalty information should be passed on to the originator of the failing settlement instruction, as appears in CSD records. In case of a link, 'the originator' may be a participant or an underlying client of a participant of the relevant linked CSD. In case of indirect and operated direct[7] link, the information flow is longer compared to a direct link. It could go from the CSD reporting the penalties to the intermediary acting on behalf of the CSD to the CSD customer of the intermediary, and then to the underlying CSD participant.) How this information flow is technically ensured is subject for specification by the involved CSDs.

Messaging and report aspects are covered in chapter 11 "Reporting" of this document.

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[6] ECSDA has taken into account that it may generate additional reporting, although believes that the participants would appreciate to be informed (ISO reporting element: "no activity"). ECSDA is open to further discussions with the relevant stakeholders on the matter.
[7] Operated means the CSD has a direct link/ account with the other CSD that is operated by an agent.

2.4 MONTHLY EVENTS

CSDs should follow the same monthly timetable to ensure that the appeal period and penalty finalisation occur on the same date.

The penalty period will be one calendar month. The below timeline for the monthly process applies:

First MONTH (computation and reporting of penalties)

Daily reporting of penalties computed for 1st business day of the month

Daily reporting of penalties computed for last business day of First month
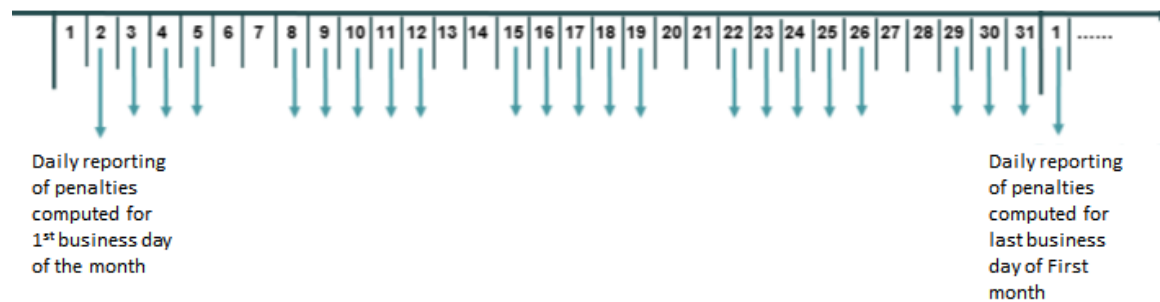
Following MONTH (provision of aggregated amounts and payment)

Daily reporting of penalties computed for last business day of previous month (i.e. First month)

11th business day = **Last day for CSDs to make corrections of** penalties from previous month. **End of appeal period** for penalties of First month

14th business day = **Provision of Monthly aggregated amounts** for penalties of previous month (i.e. of First month)

16th business day = Payment

1- Collection
2- Redistribution

2.5 MONTHLY APPEAL PERIOD

CSDs will provide a defined appeal period for participants to challenge penalty calculations post the end of a calendar month; the appeal period ends at close of business on the 11th business day of the following month.

However, this does not preclude appeals being lodged by participants at any time during the calendar month and until (and including) the 11th business day (end of appeal period) of the following month.

This ensures enough time for CSD participants and CSDs to reconcile the penalties. Any appeal can take place as from the moment of computation and reporting of the penalty and until (and including) the 11th business day of the following month, i.e. the last day for CSDs to make corrections on the penalties from the previous month.

The same applies to cross-CSD settlement (when a CSD participant initiates an appeal, this should be received on time for the CSD to lodge an appeal to the other involved CSD by close of business on the 11th business day of the following month).

Any amendment requested <u>after</u> the appeal period will generally not be taken into account by the CSD, however, exception handling may be applied.

Each time that an appeal is successful, and a change is applied to a penalty, it will be reported on the following business day. Updates made on the 11th business day of the following will be reported on the 12th business day of the following month (the same way as it is done for any other business day).

By close of business on the 14th business day of the following month, any adjustment resulting from appeals should be completed by the CSD.

Messaging and report aspects are covered in chapter 11 "Reporting".

2.6   MONTHLY AGGREGATED AMOUNTS

On the 14th business day of the following month, the CSD will report the monthly aggregated amounts for the penalties of the previous month (i.e. the aggregated amounts of the penalties computed for the business days of the previous month).

ASSUMPTION (ESMA to confirm "netting" approach): The monthly CSD reporting should include, per currency and party, the bilateral net (credit and debit payment) amounts against each of the counterparts of the penalties computed for the business days of the previous month.

For additional information on the monthly aggregated amounts, please refer to chapter 7.4 "Monthly cash penalties aggregation".

2.7   MONTHLY PAYMENT (COLLECTION & RE-DISTRIBUTION)

Latest on the 16th business day of the month, the CSD, or its participants as the case may be, will perform the payment process, i.e. the CSD should collect and re-distribute the penalties amounts.

In a "direct debit" process, the CSD will collect from its participants (that are not themselves CSDs), in a single payment, the sum of their debit (payable) bilateral net amounts against participants that are not CCPs and re-distribute to its participants which are not CCPs, the sum of their credit (entitled) bilateral net amounts, also in a single payment. CCP counterparties will need to be excluded as well.

When no direct debit is feasible, the CSD participants are due to credit the amounts due to the CSD´s dedicated cash account latest by 10.00 a.m. CET on the 16th business day of the month.

For additional information on the monthly payment process, please refer to chapter 10 "Monthly payment (Collection & re-distribution)".

3 PENALTIES SCOPE

3.1 INSTRUCTIONS SUBJECT TO CASH PENALTIES – GENERAL SCOPE

ASSUMPTION (ESMA to confirm): Settlement fails penalties should be calculated for all settlement instructions, free of or against/ with payment that are:

- "transfer orders[8]" according to the second indent of point (i) of Article 2 of Directive 98/26/EC [Settlement Finality Directive], and
- matched (prior, on or after their Intended Settlement Date (ISD)), and
- failing to settle on their ISD,
- ASSUMPTION (ESMA to confirm): with the exception of:
  - Redemptions (ISO Transaction Code equals REDM);
  - Corporate actions on stock (ISO Transaction Code equals CORP);
  - Technical instructions, e.g. (T2S) realignment, auto-collateralisation;
  - Settlement restrictions;
  - Primary issuance settlements (only in cases of pre-funding of the capital increase or debt offering, and when the pre-financing agent further distributes the securities; the process of initial creation of securities cannot be regarded as a "transfer order" from a legal standpoint[9])
  - Late matching penalties (LMFP[10]), only: Market claims (ISO Transaction Code equals CLAI).
  - payments free of delivery (PFOD), as well as Receipt Free of Payment (RFOP).

For CCP-related aspects, please refer to Chapter 12.2.

3.2 INSTRUCTIONS SUBJECT TO CASH PENALTIES - CROSS-CSD SETTLEMENTS SCOPE

ASSUMPTION (ESMA to confirm scenarios, see chapter 9 for details): In context of settlement transactions also taking place outside the CSD´s own system, the following scenarios elaborated

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[8] Definition: "Any instruction by a participant to place at the disposal of a recipient an amount of money by means of a book entry on the accounts of a credit institution, a central bank, a central counterparty or a settlement agent, or any instruction which results in the assumption or discharge of a payment obligation as defined by the rules of the system, or an instruction by a participant to transfer the title to, or interest in, a security or securities by means of a book entry on a register, or otherwise."

[9] T2S CSDR TF wording; note re. Investment funds issuance (creation/ redemption), based on ECB feedback (Remy Al Sbinati, 18.04.18): unlike for corporate actions where the Issuers are paying CSD participants, there is generally no obligation on the side of participants, for Issuance and Fund Investment the counterparties are CSD participants who are buyers, so these should be considered as normal transactions, subject to penalties.

[10] See chapter 7 for details

by T2S CSDR TF and ECSDA must be considered by CSDs to define if a failing instruction is actually subject to penalties:

1. **All involved CSDs are subject to SDR**
   ▪ The CSDs have to apply and calculate penalties for failing settlement instructions.
   ▪ This scenario also applies for settlements across interoperable links of CSDs that are both subject to CSDR SDR[11].

2. **At least one CSD is <u>not</u> subject to SDR**
   ▪ No penalties for failing settlement should be applied.
   ▪ This scenario considers especially settlements with 3rd country CSDs that are assumed to be exempted from the SDR. The CSD subject to CSDR would check whether or not the other CSD is subject to CSDR and would not apply (or in the case of T2S involvement remove the T2S-calculated) penalties.

For the detailed cross-CSD settlement scenarios, please refer to chapter 9 "Cross-CSD settlement fails".

3.3 INSTRUMENTS SUBJECT TO CASH PENALTIES

CSDs need to derive a list of ISINs subject to penalties based on various information sources.

ASSUMPTION (ESMA to confirm): If there is no ISIN and hence no fundamental data available for calculation, no penalty applies, or penalty is set to zero.

Settlement fails penalties must be calculated in case the settlement instruction in scope of SDR is failing and the instrument to be transferred is:

▪ a CSD-eligible MiFID financial instrument:
  – admitted to trading or traded on an EU trading venue (see ESMA FIRDS database[12]); or
  – cleared (or eligible for clearing) by an EU CCP.
▪ excluding shares when their principal trading venue is located in a Third Country[13].

Note: the relevant MiFID financial instruments types are:

▪ transferable securities [i.e. equity- and bond- (like) instruments (including ETFs) and giving a right to buy or sell any of those],

▪ money-market instruments,

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[11] In the T2S context, when settlement takes place between two Investor-CSDs, the subsequent realignment transactions on Issuer-CSD level shall not be subject to settlement fails penalties, independent if the Issuer-CSD is inside or outside T2S. See also ECSDA framework chapter 3.1 "Instructions Subject To Cash penalties".

[12] https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_firds

[13] CSDR Art. 7.13 states: "*This* [CSDR] *Article* [7] *shall not apply where* **the principal venue for the trading of shares** *is located in a third country. The location of the principal venue for the trading of shares shall be determined in accordance with Article 16 of Regulation (EU) No 236/2012.*" See instrument list: https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_mifid_shsexs

- UCITS and

- emission allowances.

4 IDENTIFICATION OF THE PARTY TO BE PENALISED

4.1 LATE MATCHING FAIL PENALTY (LMFP)

Any settlement instruction being in scope of the penalties calculation that is matched **after** the relevant cut-off of its ISD will be subject to computation of Late Matching Fail Penalties (LMFP) for the business day when it is matched <u>and</u> for each past business day that it failed to settle.

The penalty is charged to the participant who was last to enter or modify the relevant settlement instruction (e.g. 'accepted timestamp' is later than the one of the counterparty´s instruction) for the periods between the ISD and the day of matching of the instruction.

Note that even in cases when both parties send their instructions "late" after the ISD, only one of the two counterparts of a transaction should be imposed with a LMFP. I.e. the party with e.g. the earlier 'accepted timestamp' of its settlement instruction will not be considered as a failing party and hence no penalty will be imposed to this party in relation to the late matching.

4.1.1 LMFP special case: Already matched instructions

If a CSD is offering the possibility to send settlement instructions as already matched (i.e. both instructions are sent at the same time as matched, often used for CCP instructions), these settlement instructions will be subject to computation of LMFPs in case they are sent late.

However, it is not always possible for the CSD to determine the failing party by comparing the accepted timestamps (as both legs have the same timestamp).

In such a case, the penalty will be applied to the Instructing Party of the two settlement instructions (i.e. the party who sent the instructions to the CSD). Therefore, the CSD and the instructing Party (e.g. CCP) will have to agree how to allocate the penalty to the correct client (i.e. the delivering or the receiving participant) and adjust the penalty assignment accordingly.

4.2 SETTLEMENT FAIL PENALTY (SEFP)

Any settlement instruction, being in scope of the penalties calculation, that

- i) is matched **before** the relevant cut-off of a given business day; and
- ii) has reached its ISD; and
- iii) **fails to settle** on that ISD and following business day(s)

will be subject to computation of Settlement Fail Penalties (SEFP) for each business day the instruction is failing to settle.

A settlement instruction that "fails to settle on that business day" must be understood as a settlement instruction that is not cancelled and remaining to be settled, fully or partially, by the time of the end of processing of the relevant cut-off.

The end of processing of the relevant cut-off of each settlement instruction is the key point in time to take a "snapshot" of the status and fail reason of a settlement instruction and determine its eligibility for penalty application. A penalty will be imposed to a CSD participant if its settlement

instruction fulfils, at the time of the end of processing of the relevant cut-off, any of the below conditions:

- the instruction is **on hold** (any type of hold); or
- the instruction **failed the eligibility or provision check** with any reason associated to this instruction (lack of securities and/ or cash).

Note that it is possible that the two counterparts of a transaction are imposed with a SEFP, for example, when both legs of a matched instruction are on hold. In such scenario both parties will be imposed with a SEFP.

5 REFERENCE/ STATIC DATA REQUIRED FOR PENALTY CALCULATIONS

In order to calculate the daily settlement fails penalties, the following information needs to be available to or sourced by CSDs.

In case of missing or updated reference data, please refer to chapter 8 "Changes to previously calculated cash penalties".

5.1 LIST OF INSTRUMENTS SUBJECT TO PENALTIES

For the identification of instruments in scope, please refer to chapter 3 "Scope".

5.2 DAILY REFERENCE PRICE

CSDs need to source (or derive) and apply a daily reference price in line with CSDR Price determination rules, for those securities eligible for settlement in the CSD and whenever the instrument is in the scope of the CSDR penalty regime:

- instrument is in scope of MiFID/R:

    - shares and similar: closing price of most relevant market in terms of liquidity;

    - other instruments: closing price of the trading venue with the highest turnover;

    - ASSUMPTION (ESMA to confirm): for instruments for which no daily MiFID/R price is available, use the latest MiFID/R price or - when no MiFID/R price is available - a price determined by the CSD.

- Instrument is out of MiFID/R scope [will be rephrased if only MiFID/R instruments are in scope]:

    - market price determined by CSD, according to its price determination method as approved by the CSD´s National Competent Authority;

    - ASSUMPTION (ESMA to confirm): where no market value is available, CSDs will use:

        - for debt instruments: "nominal value";

        - for non-debt instruments: default price (e.g. issue price).

The daily reference price used for calculating the fails penalties is the price of each business day where the settlement instruction is subject to penalty calculation (i.e. using historical prices when relevant, e.g. for late matching fails), independently when the calculation is actually performed. That means that the reference price for the calculation of each penalty should be the one of the relevant fail date.

Therefore, CSDs are required to source market price data for all instruments in scope of the penalty regime on a daily basis. [MiFID/MiFID Post-trade transparency may provide the data –if the MiFID post-trade (end of day) prices will be available through a single source available to CSDs and eventually modify the assumption:] In the absence of a single price feed or source, this has to be managed via data vendors unless the CSD can source price data itself.

As a guiding principle, to avoid the application of deviating reference prices for the same ISIN by CSDs and the eventual reconciliation in a cross-CSD settlement context (see chapter 9), the involved CSDs should always apply the price used by the Issuer-CSD, if available to the involved CSDs.

Price data must be available before daily penalties applicable for the single fail date can be calculated. CSDs should therefore send the penalties data and reports to their customers including other CSDs latest by noon (12.00 o'clock CET), in line with chapter 2.3.

Generally, the prices are defined on the unit or another nominal of the ISIN. However, particular instruments require the application of pool factors or index-based pricing for example. Such particularities should be handled by the CSDs, according to market practice and in agreement with the CSD's National Competent Authority. However, special reconciliation steps may be needed in a cross-CSD settlement context (see chapter 9).

If a security price is quoted in per cent, the security's <u>denomination</u> currency should be applied for the penalties calculation.

5.3   INSTRUMENT TYPE

ASSUMPTION (ESMA to confirm): Instrument type classification will be derived from CFI code.

The "Financial Instrument Type" is a classification of securities according to which CSDs should report, as laid out in the CSDR SDR RTS.

This classification is also relevant, together with the Liquidity and SME Growth Market classifications (see below for their definition), for the identification of the applicable penalty rate for any given instruction.

Therefore, CSDs should, for each security, derive the Financial Instrument Type classification from the CFI Code of the same security, according to the following mapping table (under review by ESMA):

TABLE 1 – CFI CODE – FINANCIAL INSTRUMENT TYPE MAPPING TABLE CFI Code Structure	Financial Instrument Type
Position 1 of the code is "E"	SHRS
Position 1 of the code is "D" and position 4 is "T" or "C"	SOVR
Position 1 of the code is "D", position 2 is not "Y" and position 4 is neither "T" nor "C"	DEBT
Position 1 of the code is "R"	SECU[14]

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[14] "Securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures", i.e. Certificates, Warrants and other similar financial instruments, including Subscription Rights.

Position 1 of the code is "C" and position 2 is "E"	ETFS
Position 1 of the code is "C" and position 2 is not "E"	UCIT
Position 1 of the code is "D", position 2 is "Y" and position 4 is neither "T" nor "C"	MMKT
Position 1 of the code is "T", position 2 is "T" and position 3 is "N"	EMAL
All other CFI Code structures	OTHR

ASSUMPTION (of T2S CSDR TF; ESMA to confirm): ESMA, or another relevant market-wide body, should be responsible for providing and maintaining this mapping table.

5.4 INSTRUMENT LIQUIDITY/ ILLIQUIDITY CLASSIFICATION

The liquidity indicator is a binary classification of securities that applies to shares, i.e. when the Financial Instrument Type of the security is "SHRS" and specifies if the security is "Liquid" or "Illiquid".

This classification of securities is an attribute of the securities subject to penalties and must be derived by the CSDs from (ASSUMPTION, ESMA to confirm):

https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_fitrs_files

https://www.esma.europa.eu/policy-activities/mifid-ii-and-mifir/transparency-calculations

5.5 INSTRUMENT TRADING SEGMENT LISTING ("SME GROWTH MARKET")

The SME Growth Market indicator is a binary classification of securities that applies for any type of securities and that specifies whether the security is listed in a SME Growth Market.

CSDs need to identify whether the instrument in scope is listed on an EU SME Growth Market. As such, it is not relevant for the CSDs to know if the actual trade took place on a SME Growth Market venue.

ASSUMPTION (ESMA to confirm): ESMA to publish ISINs listed on SME growth markets.

5.6 INSTRUMENT CATEGORY PENALTY RATE

Considering all the previously mentioned decision criteria, CSDs should apply the ESMA penalty rates as published in the delegated regulation 2017/389: [15]:

Type of fail	Rate

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[15] Commission Delegated Regulation (EU) 2017/389, of 11 November 2016, supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council as regards the parameters for the calculation of cash penalties for settlement fails and the operations of CSDs in host Member States. Published at: http://eur-lex.europa.eu/eli/reg_del/2017/389/oj. When applicable, updates will be provided by ESMA.

1. Settlement fail due to **a lack of shares that have a liquid market** within the meaning of point (b) of Article 2(1)(17) of Regulation (EU) No 600/2014, excluding shares referred to in point 3	1,0 basis point
2. Settlement fail due to **a lack of shares that do not have a liquid market** within the meaning of point (b) of Article 2(1)(17) of Regulation (EU) No 600/2014, excluding shares referred to in point 3	0,5 basis point
3. Settlement fail due to a **lack of financial instruments traded on SME growth markets**, excluding debt instruments referred to in point 6	0,25 basis point
4. Settlement fail due to a **lack of debt instruments** issued or guaranteed by: 　(a)　a sovereign issuer as defined in Article 4(1)(60) of Directive 2014/65/EU; 　(b)　a third country sovereign issuer; 　(c)　a local government authority; 　(d)　a central bank; 　(e)　any multilateral development bank referred to in the second subparagraph of Article 117(1) and in Article 117(2) of Regulation (EU) No 575/2013 of the European Parliament and of the Council (¹); 　(f)　the European Financial Stability Facility or the European Stability Mechanism.	0,10 basis point
5. Settlement fail due to a **lack of debt instruments other** than those referred to in points 4 and 6	0,20 basis point
6. Settlement fail due to a **lack of debt instruments traded on SME growth markets**	0,15 basis point
7. Settlement fail due to a **lack of all other financial instruments** not covered in points 1 to 6	0,5 basis point

8. Settlement fail due to a **lack of cash**	Official interest rate for overnight credit charged by the central bank issuing the settlement currency with a floor of 0 (zero)

5.7 CENTRAL BANK DISCOUNT RATE (PENALTIES DUE TO LACK OF CASH)

CSDs must source the relevant discount rate for the relevant currency of the failing settlement instruction in case the fail reason is "lack of cash". EUR discount rates are published by the ECB on their website[16]; for non-EUR currencies, the relevant Central Banks should be consulted.

CSDs will discuss further the following aspects:

- Format for receiving the data and rates to be used in the calculation is to be agreed.
- Potential for single database listing all relevant cash discount and FX rates.

5.8 FOREIGN EXCHANGE (FX) RATES

As explained in chapter 6 "Currency related aspects", for cross-CSD DVP and FOP instructions penalties, a FX conversion to EUR default currency may be required (e.g. daily reference price or DVP cash leg is in SEK; conversion from SEK to EUR is required).

CSDs must then source the relevant FX rate for the relevant currency of the failing settlement instruction (EUR FX rates are published by ECB on their website[17]).

5.9 OTHER REFERENCE DATA ASPECTS

CSDs will check if Post-trade transparency under MiFID/R is sufficient. For MiFID/R reporting ISO 20022 is the standard used for reporting.

If data from public sources is not sufficient, CSDs will need to consider the following elements:

- In case of supplementing the data with the information received from data vendors, are the CSDs allowed to share reference data across CSDs?

- If data can be shared, can it also be shared outside CSDs, with customers or other parties interested in penalty related data (incl. T2S)?

- Which report/ data formats should be applied?

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[16] Discount rates would be updated by the corresponding to the currency EU Central Banks. For the ECB rates, please see http://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html.http://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html.http://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html.http://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html.

[17] http://www.ecb.europa.eu/stats/exchange/eurofxref/html/index.en.html

6 DIVERGENT CURRENCIES

This chapter defines the approach to be taken in cross-CSD scenarios and when the currency of the reference price or cash penalty differs from the domestic currency of the involved CSD(s).

ASSUMPTION (yet **to be approved by ECSDA Board): Apply EUR currency by default for DVP and FOP instructions, in case of cross-CSD instructions where the settlement currencies used by CSDs differ.**

The penalties amounts will have to be converted into Euro as from the date of detection (settlement fail date (EUR FX rates are published by the ECB on their website[18])) and used all along the chain, for reporting, book-keeping, monthly aggregation and payments execution purposes.

It is to be noted that no cash is expected to be exchanged on a daily basis. With regard to the monthly penalty reporting and collection and redistribution, it should be noted that:

- The monthly reporting should aggregate, divided by applicable currency, the (converted) penalty amounts actually to be received by or paid from the CSD, as calculated by the CSD in the daily reports of the penalty calculation period (i.e. the <u>amounts are only displayed in the currency (i.e. EUR) in which the payment is to be collected or redistributed</u>).
- Subsequently, for the monthly penalty collection and redistribution process, the currencies and amounts as reported in the Monthly penalty reporting apply and must be collected and redistributed in the currency reported (i.e. EUR).

6.1 AGAINST PAYMENT TRANSACTIONS

All penalties will be calculated based on the settlement cash leg or reference price currency but converted into EUR by default[19] for the following processes:

1. The calculation and reporting of the daily penalty; and
2. The calculation and reporting of the monthly aggregated penalties; and
3. The calculation and reporting of the amount to be paid and to be received; and
4. The collection and re-distribution (payment).

That means that the CSD responsible for the process should:

1. Convert the single reference price into EUR; and
2. Calculate the amount of the daily penalty in EUR; and
3. Report the applied EUR FX rate(s) in the daily penalty reporting.

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[18] http://www.ecb.europa.eu/stats/exchange/eurofxref/html/index.en.html

[19] Applying the currency of the cash leg has been dismissed due to reduce complexity; note that T2S applies the currency of the cash leg (i.e. EUR or DKK as of October 2018), i.e. slightly deviates from the Framework approach.

6.2   FREE OF PAYMENT TRANSACTIONS

All penalties will be calculated based on the reference price currency but converted into EUR for the following processes:

1. The calculation and reporting of the daily penalty; and
2. The calculation and reporting of the monthly aggregated penalties; and
3. The calculation and reporting of the amount to be paid and to be received; and
4. The collection and re-distribution (payment).

That means that the CSD responsible for the process should:

1. Convert the single reference price into EUR; and
2. Calculate the amount of the daily penalty in EUR; and
3. Report the applied EUR FX rate(s) in the daily penalty reporting.

7   CALCULATION METHODS OF THE CASH PENALTIES

7.1   SETTLEMENT FAIL PENALTY (SEFP)

Once a failing settlement instruction has been identified as subject to computation of SEFP according to the detection rules described in chapter 3 "Scope" and it was determined that a penalty is imposed (refer to chapter 4 "Identification of the party to be penalised"), the CSD can calculate the penalty to be applied.

The amount imposed by the penalty must be calculated depending on: (i) the type of transaction formed by the two matched settlement instructions using reference data, (ii) penalty rate or discount rate (Central Bank interest rate on cash) for the financial instrument exchanged by the transaction and (iii) whether the instruments need to be delivered or received by the counterparty.

It is to be noted that:

- For the management of the penalties in different currencies, please refer to chapter 6 "Divergent currencies ".
- For various calculation examples, please refer to the T2S Penalty Mechanism document (see Annex).

ASSUMPTION (ESMA to confirm, also whether PFOD and RFOP are exempt): The following table summarises the basis for calculating the amount imposed by the penalty for each type of transaction:

Type of transaction	SEFP
i. Transactions with exchange of securities versus cash - Delivery versus Payment (DVP) - Receipt versus Payment (RVP)	If the transaction fails due to a lack of securities, the penalty is based on the quantity of securities failed to be delivered and penalty rate of the ISIN. If the transaction fails due to a lack of cash, the penalty rate is based on the quantity of securities failed to be delivered and the discount rate of the relevant currency *Note: the amount for the penalty should be calculated based on the quantity of securities failed to be delivered (instead of the cash amount failed to be delivered) even when fail is due to a lack of securities or cash.*

ii. Transactions with exchange of securities only[20] - Delivery Free of Payment (DFOP) - Receipt Free of Payment (RFOP)	Penalty based on the quantity of securities failed to be delivered and penalty rate of the ISIN
iii. Transactions with exchange of cash only[21] - Debiting Payment Free of Delivery (DPFOD) - Crediting Payment Free of Delivery (CPFOD)	Penalty based on the amount of cash failed to be delivered and the discount rate of the relevant currency
iv. Transactions with exchange of securities and cash (i.e. same direction)[22] - Delivery with Payment (DWP) - Receiving with Payment (RWP)	Penalty will be the sum of: - The penalty based on the quantity of securities failed to be delivered and penalty rate of the ISIN (case ii); and - The penalty based on the amount of cash failed to be delivered and the discount rate of the currency (case iii)

The formulas to calculate the amount imposed by a Settlement Fail Penalty (SEFP) are the following:

- **i. For DVP and RVP Settlement Instructions:** SEFP = Rate* Reference Price* Quantity

  – **Rate** is:

    - If the instruction fails due to lack of securities: the flat penalty rate stored in Static Data for the asset type of the ISIN of the failed instruction (according to ESMA's classifications) for the business day on which the penalty occurred;

    - If the instruction fails due to lack of cash: the discount rate of the relevant currency stored in Static Data (according to ESMA definitions) for the business day on which the penalty occurred.

  – **Reference Price** is the price stored in Static Data for the ISIN of the instruction for the business day on which the penalty occurred.

  – **Quantity** is the quantity of securities failed to be delivered, which is the quantity of the instruction remaining to be settled at the time of end of processing of the relevant cut-off.

- **ii. For DFP and RFP Settlement Instructions:** SEFP = Rate* Reference Price* Quantity

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[20] Also known as Delivery with Zero Payment (DOP)/ Receipt with Zero Payment (ROP) in some markets.

[21] Those transactions are mostly used in the context of CA on stock for payment of cash proceeds, but can also result from CA on flows (market claims) and CCP netted transactions

[22] Those transactions are mostly the result from CCP netted transactions

- **Rate** is the flat penalty rate stored in Static Data for the asset type of the ISIN of the failed instruction (according to ESMA's classifications) for the business day on which the penalty occurred.

- **Reference Price** is the price stored in Static Data for the ISIN of the instruction for the business day on which the penalty occurred.

- **Quantity** is the quantity of securities failed to be delivered, which is the quantity of the instruction remaining to be settled at the time of end of processing of the relevant cut-off.

- **iii. For DPFOD and CPFOD Settlement Instructions:** SEFP = Rate* Amount

    - **Rate** is the discount rate of the relevant currency stored in Static Data (according to ESMA definitions) for the business day on which the penalty occurred.

    - **Amount** is the cash amount failed to be delivered, which is the amount of the instruction remaining to be settled at the time of end of processing of the relevant cut-off[23].

- **iv. For DWP and RWP Settlement Instructions:** SEFP = SEFP for the securities side + SEFP for the cash side

    - **SEFP for the securities side** is the one calculated following the formula of case ii.

    - **SEFP for the cash side** is the one calculated following the formula of case iii.

7.2 LATE MATCHING FAIL PENALTY (LMFP)

For settlement instructions that are matched in the CSD system only after the relevant cut-off of their Intended Settlement Date (ISD), penalties should be calculated only once (i.e. on the business day when they are matched) but considering all the <u>previous</u> business days where the instruction failed to settle due to the late matching.

Settlement Fail Penalties (SEFP) and Late Matching Fail Penalties (LMFP) should follow the same principles for their computation.

ASSUMPTION (ESMA to confirm, also with regard to PFOD and RFOP): The following table summarises the basis for calculating the amount imposed by the penalty for each type of transaction:

Type of transaction	LMFP
i. Transactions with exchange of securities versus cash - Delivery versus Payment (DVP)	Penalty based on the quantity of securities failed to be delivered and penalty rate of the ISIN.

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[23] Rationale: Although the CSDR prescribes to use the security quantity and reference price for the calculation of all settlement fail penalties, for DPFOD and CPFOD settlement instructions where the ISIN quantity is 0, the assumption is to use the cash amount to compute the penalty.

- Receipt versus Payment (RVP)	
	Note: given that we are in a late matching scenario, it is not possible to have the reason for failing "Lack of cash"; hence, the penalty rate of the ISIN is always used.
ii. Transactions with exchange of securities only[24] - Delivery Free of Payment (DFOP) - Receipt Free of Payment (RFOP)	Penalty based on the quantity of securities failed to be delivered and penalty rate of the ISIN
iii. Transactions with exchange of cash only - Debiting Payment Free of Delivery (DPFOD) - Crediting Payment Free of Delivery (CPFOD)	Penalty based on the amount of cash failed to be delivered and the discount rate of the relevant currency
iv. Transactions with exchange of securities and cash (i.e. same direction) - Delivery with Payment (DWP) - Receipt with Payment (RWP)	Penalty will be the sum of: - The penalty based on the quantity of securities failed to be delivered and penalty rate of the ISIN (case ii); and - The penalty based on the amount of cash failed to be delivered and the discount rate of the currency (case iii)

The formulas to calculate the amount imposed by a Late Matching Fail Penalty (LMFP) will differ depending on whether the instruction subject to LMFP can either still settle, or no longer settle, on the business day when the instruction is matched (i.e. depending on whether it is matched before or after the relevant cut-off for the Matching Business Day).

1. **When the instruction can still settle on the business day when it is matched:**

   - This scenario relates to those instructions matched after their ISD (late matching), but matched at a point in time when it is still possible to settle them on the business day when they are matched (i.e. matched before the relevant cut-off for Matching Business day).

   - The LMFP should be calculated for each business day as from the ISD until, and excluding, the business day when the instruction is matched.

   - In case the instruction does not settle on the business day when it is matched (even if it was possible because it arrived before the cut-off) then, a separate calculation will have to be performed for an additional SEFP.

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[24] Also known as Delivery with Zero Payment (DOP)/ Receipt with Zero Payment (ROP) in some CSDs.

The matching date is excluded from the LMFP and included in the SEFP.

2. **When the instruction can no longer settle on the business day when it is matched:**

   ▪ This scenario relates to those instructions matched, on or after the ISD, at a point in time when it is not possible to settle them on the business day when they are matched, because it is after the relevant cut-off.

   ▪ The LMFP should be calculated for each business day as from the ISD until, and including, the business day when the instruction is matched.

The matching date is included in the LMFP and excluded from the SEFP.

Re. scenario 1, the applicable formulas are as follows:

i. For DVP and RVP Settlement Instructions; and ii. For DFP and RFP Settlement Instructions[25]:

$$LMFP = \sum_{n=1}^{N}(\text{Rate day x} * \text{Reference Price day x} * \text{Quantity})$$

   – **N** is equal to the number of business days resulting from the difference between the "ISD and the Matching Business Day (MBD)".
   – **Rate** is the flat penalty rate stored in Static Data for the asset type of the ISIN of the failed instruction (according to ESMA definitions) and for the relevant business day (x). Mathematically is "x= MBD – n".
   – **Reference Price** is the price stored in Static Data for the ISIN of the instruction and for the relevant business day (x). Mathematically is "x= MBD – n".
   – **Quantity** is the quantity of securities failed to be delivered, which is the matched quantity of the Settlement Instruction. Given that LMFP relate to the matching time, it is not the remaining quantity at cut-off time like in SEFP but the matched quantity.

iii. For DPFOD and CPFOD Settlement Instructions (ISIN quantity is 0): $LMFP = \sum_{n=1}^{N}(\text{Rate day x} * \text{Amount})$

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[25] Given that in LMFP, there is no possibility to have a "Lack of cash" (i.e. the fail is always due to a late sending of the instruction causing the late matching), the formula used is the same in both cases (i. and ii.) because the rate is always the rate for the ISIN.

- **N** is equal to the number of business days resulting from the difference between the "ISD and the Matching Business Day (MBD)".
- **Rate** is the discount rate of the relevant currency stored in Static Data (according to ESMA definitions) and for the relevant business day (x). Mathematically is "x= MBD – n"
- **Amount** is the cash amount failed to be delivered, which is the matched cash amount of the Settlement Instruction. Given that LMFP relate to the matching time, it is not the remaining amount at cut-off time like in SEFP but the matched amount.

iv. For DWP and RWP Settlement Instructions: LMFP = LMFP for the securities side + LMFP for the cash side

- **LMFP for the securities side** is the one calculated following the formula of case i and ii.

- **LMFP for the cash side** is the one calculated following the formula of case iii.

Re. scenario 2 the applicable formulas are as follows:

Everything will be the same as for instructions that can still settle but, additionally, the business day when the instructions are matched must be included. I.e. The relevant formulas will be the same but with "n" starting with zero (staring with **n=0** instead of with n=1), in order to include in the calculation the business day where the instructions are matched.

i. For DVP and RVP Settlement Instructions; and ii. For DFP and RFP Settlement Instructions[26]:
$$LMFP = \sum_{n=0}^{N}(\text{Rate day x} * \text{Reference Price day x} * \text{Quantity})$$

- **N** is equal to the number of business days resulting from the difference between the "ISD and the Matching Business Day (MBD)".

- **Rate** is the flat penalty rate stored in Static Data for the asset type of the ISIN of the failed instruction (according to ESMA definitions) and for the relevant business day (x). Mathematically is "x= MBD – n".

- **Reference Price** is the price stored in Static Data for the ISIN of the instruction and for the relevant business day (x). Mathematically is "x= MBD – n".

- **Quantity** is the quantity of securities failed to be delivered, which is the matched quantity of the Settlement Instruction. Given that LMFP relate to the matching time, it is not the remaining quantity at cut-off time like in SEFP but the matched quantity.

iii. For DPFOD and CPFOD Settlement Instructions (ISIN quantity is 0): $LMFP = \sum_{n=0}^{N}(\text{Rate day x} * \text{Amount})$

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[26] Given that in LMFP, there is no possibility to have a "Lack of cash" (i.e. the fail is always due to a late sending of the instruction causing the late matching), the formula is the same in both cases because the rate is always the rate for the ISIN.

- **N** is equal to the number of business days resulting from the difference between the "ISD and the Matching Business Day (MBD)".
- **Rate** is the discount rate of the relevant currency stored in Static Data (according to ESMA definitions) for the relevant business day (x). Mathematically is "x= MBD – n"
- **Amount** is the cash amount failed to be delivered, which is the matched cash amount of the Settlement Instruction. Given that LMFP relate to the matching time, it is not the remaining amount at cut-off time like in SEFP but the matched amount.

iv. For DWP and RWP Settlement Instructions: LMFP = LMFP for the securities side + LMFP for the cash side

- **LMFP for the securities side** is the one calculated following the formula of case i and ii.

- **LMFP for the cash side** is the one calculated following the formula of case iii.

7.3 DAILY CASH PENALTIES AGGREGATE

In addition to the gross penalties calculated on a daily basis, a bilateral net amount per counterparty should also be provided.

For each relevant business day, a net amount is calculated for the party against each of its counterparties.

Thus, for a given party, the bilateral net amount (due or entitled) against a given counterparty is:

- The sum of all the penalties (SEFP + LMFP) calculated at the failed instruction level that this party is entitled to receive (reported as credit) from a given counterparty (i.e. to be paid by this counterpart);

minus

- The sum of all the penalties (SEFP + LMFP) calculated at the failed instruction level that are imposed to the party (reported as debit) and to be paid to the same counterparty.

If the result is a positive amount, the bilateral net amount will be a credit for the party (i.e. an amount entitled from the counterpart) and if the result is a negative amount, the bilateral net amount will be a debit (i.e. an amount due to the counterpart).

7.4 MONTHLY CASH PENALTIES AGGREGATION

ASSUMPTION (ESMA to confirm penalties "netting" approach and whether CSDs should collect and distribute cash penalties instead of CCPs for their members): On the 14th business day of the month, bilateral net amounts of the penalties computed for all the business days of the previous month is calculated per currency and party against each of its counterparties.

When calculating the monthly aggregated amounts, the CSD will consider the last available value of the amount of each penalty aggregated (i.e. the CSD will take into account all the modifications performed until the end of the penalties appeal period, i.e. changes until and including the 11th business day of the following month).

This **aggregation** of the monthly penalties per counterpart (bilateral net amounts) allows to:

- Isolate the amounts of the CCPs that should not be collected and re-distributed by the CSD [to be clarified by ESMA];
- Isolate non-payments from CSD participants (i.e. participants affected by a non-payment of its counterpart as well as the amount that cannot be distributed by the CSD since it was not collected could be easily identified);
- Limit the financial risks by a CSD (who must first collect and only distribute the penalty amounts afterwards), for example in a cross-CSD scenario where several actors will have to reconcile the amounts that can be paid or distributed [To be acknowledged by ESMA that the absence of direct debit of CSD participants cash accounts for some CSDs may prevent efficient collection and redistribution of penalties];
- Provide a netting as required by the CSD-Regulation;
- Reduce the required liquidity.

Accordingly, for each party and currency, the monthly bilateral net amount equals to:

- The sum of all the cash penalties of the previous month in the relevant currency, that the party is entitled to receive (reported as credit) from a given counterparty (i.e. to be paid by this counterparty);

Minus

- The sum of all the cash penalties of the previous month in the relevant currency and that were imposed to the party (reported as debit), and to be paid to the same counterparty.

If the result is a positive amount, the bilateral net amount will be a credit for the party (i.e. an amount entitled to be received from the counterpart) and if the result is a negative amount, the bilateral net amount will be a debit (i.e. an amount due to the counterpart).

7.5 CALCULATION OF THE MONTHLY AMOUNT TO BE PAID/ TO BE RECEIVED

On the 14th business day of the month, two aggregated credit and debit amounts of the monthly net bilateral amounts are calculated per currency and party.

Accordingly, for each party and currency, the monthly credit and debit amounts equal to:

- The sum of all the net bilateral amounts in the relevant currency, that the party is entitled to receive (reported as credit and for all counterparties);
- The sum of all the net bilateral amounts in the relevant currency and that were imposed to the party (reported as debit and for all counterparties)

Two amounts will result from this calculation:

- The global monthly credit amount for the party (i.e. an amount entitled from all the counterparties)

and

- The global debit amount for the party (i.e. an amount due to all the counterparties).

8 CHANGES TO PREVIOUSLY CALCULATED CASH PENALTIES

Updates of previous penalty calculations should be done by the CSD as soon as the reference data becomes available to the CSD and considering the appeal period. If data required for calculating penalties is available to the CSD only after the reporting month, retroactive penalties calculations should be made by CSDs latest until the 11th business day of the following month (i.e. end of the appeal period). That means that if new or updated data for calculating penalties is available to the CSD only after the 11th business day, no retroactive penalties calculations or adaptations would be made by CSDs.

8.1 REMOVAL OF EXISTING PENALTIES

Although we have not noted this on the final CSDR SDR standards, according to ESMA´s Technical Advice under the CSD Regulation (point 57 in page 17): "*in the limited circumstance where settlement cannot be performed for reasons that are independent from any of the participants or the CSD, the penalty would not be charged. In order to achieve that exception, it should be possible to reduce the amount of the penalty to zero. Examples of these occurrences may be a suspension of the instrument from trading and settlement due to reconciliation issues, specific corporate actions which imply the instrument no longer exists, or technical impossibilities at the CSD level. In order to prevent abuse, these exemptions should be approved by the Competent Authority, either through approval of the CSD procedures detailing in which specific cases penalties do not apply, or on a case by case basis*".

As a consequence, CSDs may remove an already computed and reported penalty (i.e. to reduce the amount of the penalty to zero) until (and including) the 11th business day of the following month. When the removal of a penalty is performed, the CSD should provide a description of the reason why the penalty is removed, i.e. set to zero.

ESMA to confirm and ECSDA Board to agree: in case the client fail is caused by a CSD processing/ technical instruction fail, the CSD should put the penalty to zero (e.g. in T2S, the realignment for a cross-CSD transaction is linked with the client-instructions and settles on an all-or-none basis. It may rarely happen that the source of the fail is a lack of the realignment whereas clients have a sufficient position).

The CSD should also report the removal of a penalty at the time of the creation of the following Daily Report:

- On the following business day after the removal of the penalty, the CSD should generate the **Daily Report** with the penalties computed for the previous day, including the penalties that have been removed since the generation of the reports of the previous business day.

- Within this report, the penalties that have been set to zero will be reported with:

    – New amount equal to zero; and

    – Status "Removed"; and

    – The description (free text) of the reason for the removal (provided by the CSD).

8.2   Re-inclusion of a previously removed penalty

CSDs may re-include already removed penalties as from when e.g. updated information becomes known to the CSD and until (and including) the 11th business day of the following month (monthly aggregation).

When a penalty is re-included, CSDs should calculate the penalty amount again as it may have changed due to updates in the reference data since it was removed. This recalculation should be performed in the next CSD daily recalculation process.

CSD should report the re-inclusion (penalty with status "active") together with the recalculated amount in the regular daily report of the following day, split per business day (for both, the failing and the non-failing party, if applicable). No "modified penalties" report will be provided.

8.3   Update of existing penalties

Upon changes of values of the related reference data, CSDs should recalculate affected penalties (those that used the modified reference data in their calculation) and update the penalty in case their details have changed, for example if there is a new amount due/ entitled to receive.

The related reference data triggering the re-calculation and possible update of a penalty are:

- Changes in the reference price of a given ISIN for a given business day that was used for the calculation of the penalty;

- Changes in the values of the securities subject to penalties that was used in the calculation of the penalty (i.e. for a given ISIN, the changes of the value of the Financial Instrument Type, the Liquidity or the SME Growth Market);

- Changes in the values of the Daily Flat Penalty Rate that was used in the calculation of the penalty (either the Securities Penalty Rate or the Discount Rate).

On the following day, after the recalculation of a penalty, CSDs should generate a report (per business day) with the penalties computed for the previous day; and the updated penalties since the generation of the reports of the previous business day.

The penalties that have been updated should be reported with:

- New updated amount and values; and

- Flag "Updated".

CSDs should recalculate and update a penalty after changes in the related reference data as from when the updated information is known until (and including) the 11th business day of the following month (monthly aggregation).

9 CROSS-CSD SETTLEMENT FAILS

9.1 INTRODUCTORY CONSIDERATIONS

ASSUMPTION (ESMA to confirm): In context of settlement transactions also taking place outside the CSD´s own system, the following scenarios elaborated by T2S CSDR TF and ECSDA must be considered by CSDs to define whether or not a failing instruction is actually subject to penalties.

ECSDA and the T2S CSDR TF jointly support a simple and consistent approach:

- that can be applied independently from the Issuer CSD/ Investor CSD relationship,
- applied independently from the account configuration, and
- is also platform agnostic, i.e. the approach applies regardless whether CSDs to the transaction share a common settlement infrastructure or not.

The general principle is that penalties apply to every matched settlement instruction failed in a CSD[27], irrespective of whether it involves the issuer-CSD or the investor-CSD, and provided that all CSDs involved in the transaction are subject to CSDR (see also Section 2.4 Further considerations ECSDA). This way, failing CSD participants are directly penalised by their CSD(s)[28].

The relevant scenarios[29] described below allow for a minimum complexity and operability of the penalty application approach by all CSDs. Please note that the scenarios described presume that settlement penalties (and buy-ins in case of alignment of transactions) should result and be deemed by the market actors as bringing higher benefits rather than a burden. The authorities should keep in mind that in case of higher perceived burden by the relevant stakeholders (the buyer and seller and their intermediaries), the proposed scenarios may need to be reviewed to prevent either party from escaping from the obligation of compliance with the regulation.

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[27] Independently of the settlement platform used by the CSD

[28] In the case where CSDs involved in the settlement chain are participating in the T2S platform, CSDs can benefit from the T2S calculation of the cash penalty directly at the level of the investor CSD (i.e. the end of the settlement chain), hence simplifying their process. Because of the integrated settlement infrastructure of the T2S platform and the settlement on an all-or-none basis among all the CSDs involved, there is no need to compute cash penalties and pass them on through all CSDs across the whole settlement chain, i.e. T2S applies penalties for all T2S settlements (except for T2S realignment instructions) and calculates and reports the penalties directly to the participants at both ends of the settlement chain. The CSDR TF has reflected this logic in the envisaged design of the T2S penalty mechanism.

[29] Note: The T2S penalty mechanism does not take into consideration whether one CSD is subject to CSDR Settlement Discipline Regime (SDR) or not. In the current design of the T2S penalty mechanism, it has been agreed with the T2S CSDR TF that in cases where penalties should not apply due to the above, CSDs will remove the penalties ex post with the dedicated functionality in the T2S platform. Hence, this dimension is not reflected below as it does not affect the end result. Also note that the scenarios assume that all relevant criteria (ISIN code, instruction type etc.) match the scope of the penalties regime according to CSDR and its subsequent RTS and guidelines.

9.2 CROSS-CSD INSTRUCTIONS SUBJECT TO PENALTIES

All involved CSDs are subject to SDR:

Scenarios	In SDR	Out SDR	Penalties
1	Both CSDs (processing the order of the buyer and the seller)		Penalties to be applied by both CSDs

Both CSDs in the settlement transaction are <u>falling under SDR,</u> i.e. penalties would apply and be calculated by both CSDs[30].

The CSDs should use the same reference data/ prices for the calculation of penalties; the same currency (mainly related to free of payment transactions), daily and monthly reporting and penalties (re-) distribution apply, as described in the relevant chapters of this document. The penalty price sourced from the Issuer CSD should be applied.

CSDs need to establish frequent reconciliation steps to avoid breaks in the monthly cash collection and redistribution process.

9.3 CROSS-CSD INSTRUCTIONS <u>NOT</u> SUBJECT TO PENALTIES

At least one CSD is <u>not</u> subject to SDR:

Scenarios	In SDR	Out SDR	Penalties
2		Both CSDs (processing the order of the buyer and the seller)	Not falling under the Framework

Both CSDs in the settlement transaction are <u>not falling under the Framework</u>.

Scenarios	In SDR	Out SDR	Penalties
3	CSD (processing the order of the buyer or the seller)	CSD (processing the order of the buyer or the seller)	The scenario is currently under further consideration

The scenarios are currently under further discussion.

9.4 RECONCILIATION ASPECTS

In cross-CSD settlement scenarios, the involved CSDs will perform all the calculations and report them to each other.

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[30] This scenario also applies to. Clearstream - Euroclear Bridge.

Based on the received reports, the CSDs should reconcile the details of the penalties provided with the penalties calculated in their own systems (theoretically for the same amount).

CSDs must not distribute penalties it has not actually collected (received). Any penalties amount deviations will require consideration in the reconciliation and monthly payment process, i.e. in case of differences, the CSDs need to communicate amongst each other and solve the deviations in a timely manner, prior to the start of the monthly billing process.

If a CSD is closed and another CSD is open, then the second will likely report daily penalties to the first. It should be considered for the purpose of the reconciliation that the first CSD would then ask the second CSD to cancel all the reported penalties for that day.

This is especially important since no tolerances (in terms of the monthly aggregated amounts collected) applies (see chapter 10.2).

Reconciliation differences are likely to occur at least in the following situations:

1. *Reference data deviations*

Penalties calculations are based on various reference data, e.g. daily reference price or FX rates.

In a cross-CSD context, [subject to further analysis of what may be available through ESMA] in the absence of a central, single source of information, this may lead to the application of deviating reference data for the same ISIN or failing instruction by CSDs and subsequently reconciliation need in a cross-CSD settlement context.

2. *CSD participant insolvency*

CSDs must exchange information in case a CSD participant becomes insolvent, leading to the inability of the CSDs to (fully) collect the penalties due. Processed will be detailed further at a later stage.

3. *Suspension of settlement*

Final CSDR SDR standards stipulate that no penalties should be applied once a CSD has suspended settlement of an ISIN, e.g. due to an "undue creation/ deletion of securities" reconciliation break.

ESMA to confirm the ASSUMPTION: If a CSD suspends settlement, only the other CSDs below it in the securities holding chain should suspend settlement of transactions in the suspended ISIN.

Similarly to insolvency, CSDs must exchange information in case a CSD suspends an ISIN from settlement (due to an "undue creation/ deletion of securities" reconciliation break) leading to the inability of a CSD to (fully) collect the penalties due in case only one CSD applies such suspension (i.e. the suspending CSD would cease penalties application while the other CSD continues to calculate them).

As CSDs must not distribute penalties it has not collected, settlement suspension requires consideration in the reconciliation and monthly payment process.

10 COLLECTION & REDISTRIBUTION OF PENALTIES (PAYMENT)

10.1 GENERAL OVERVIEW

Collection and Redistribution of Penalties refers to the monthly exchange of cash between CSDs and CSD-Participants.

- ▪ In this respect, the relevant articles of the CSDR SDR Standards state in Article 17 *Collection and distribution of cash penalties:*

Quote

1. CSDs shall charge and collect on at least a monthly basis the net amount of cash penalties to be paid by each failing participant.

Cash penalties shall be deposited into a dedicated cash account.

2. CSDs shall distribute on at least a monthly basis the net amount of cash penalties referred to in paragraph 1 to receiving participants affected by settlement fails. CSDs should not take any financial risk with the management of the payment of the penalties.

Unquote

Derived from the above, the overall process consists of three major steps that should be performed completely (partial payment is not foreseen) on the same day per every currency involved:

1. Collection;
2. Redistribution to other CSDs (only in cross-CSD scenarios);
3. Redistribution to CSD-participants.

Usually, a CSD-participant has an amount to pay ("due") and an amount to receive ("entitlement") to or from its CSD.

For cross-CSD payments, one CSD has to pay and the other to receive. A net debit and a net credit will be exchanged i.e. collect and then distribute.

It is to be noted that CSDs should not issue "invoices" for the payments relating to the transfer of penalties. After the calculation is done (see chapter 7 "Calculation methods of the cash penalties") and the monthly aggregated report was sent (see chapter 11 "Reporting"), the transfer of the cash relating to the penalties will take place. This should be done separately from the costs of running the mechanism[31].

Illustrative example:

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[31] Invoices should only be used by the CSD to recharge its development and running costs relating to the management of its penalty mechanism (see extract from the CSDR SDR RTS - Article 18 (3): *"CSDs shall charge participants separately for the costs of the penalty mechanism (…)"*).

Participant A — EUR 110, EUR 280
Participant B — EUR 160, EUR 140
CSD X — EUR 150 — CSD Y
EUR 220, EUR 30 — Participant C
EUR 60, EUR 100 — Participant D

Collection
Redistribution to CSD
Redistribution to CSD-participant
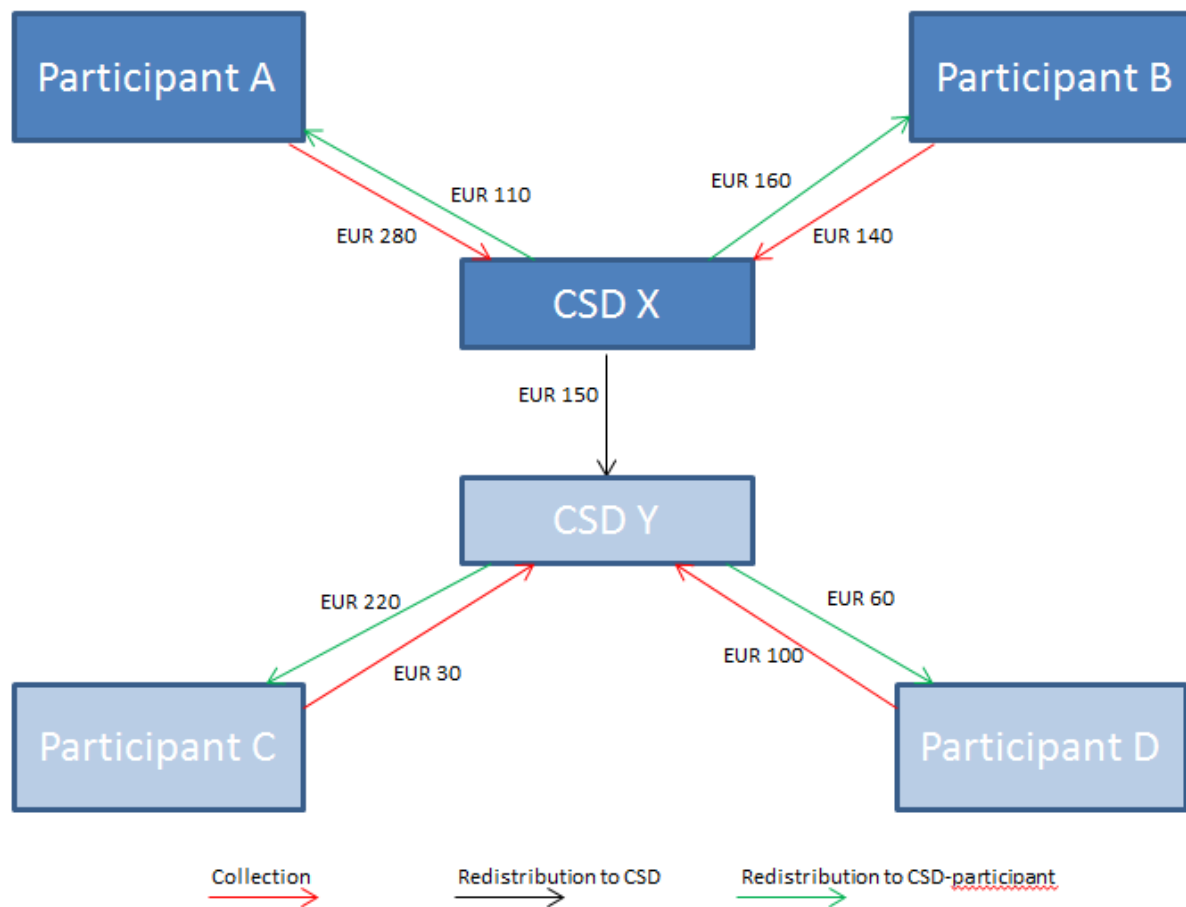
Source: T2S CSDR TF, ECSDA

10.2 PENALTIES COLLECTION

Participants must pay their dues to the CSD on a dedicated CSD cash account for the management of the penalties from the day of the receipt of the final report on the amounts (latest on the 16th business day; see chapter 2 "Penalties Lifecycle and Business Days Calendar" for details).

No tolerance between the amount to be paid and the amount actually collected is allowed, i.e. CSD participants must pay exactly the amount calculated and reported by the CSD in its monthly aggregated penalties report. As otherwise, the CSD may not be allowed to perform the penalties re-distribution to its receiving participants (including other CSDs in a cross-CSD penalties scenario).[32]

10.2.1 Direct debit

Whenever legally and/or contractually allowed, the CSD should collect the money by directly debiting the cash accounts of its participants (that are not itself CSDs). Such process will avoid

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[32] Note that some CSDs may today not be allowed to keep cash balances overnight. For the purpose of cash penalties processing, impacted CSDs should arrange for an exception agreement with its relevant NCA.

delays and differences in the amounts expected and collected by the CSD and subsequent blocking of the cash distribution process.

10.2.2 Cash transfer (no direct debit)

In the exceptional case when direct debit is not feasible, the CSD participants will have to actively transfer the amounts due to the dedicated cash account of their CSD latest on the 16th business day of the following month[33].

The same applies for the exchange of cash amounts between CSDs (see chapter 10.3).

Please also see the open questions listed in chapter 12.1 in relation to partially failing cash collections. [ESMA to acknowledge the risks related to the absence of direct debit and is asked to consider appropriate mechanisms to enforce the timely payment of due amounts.]

10.3 PENALTIES REDISTRIBUTION (CROSS-CSD SCENARIO)

While a delay in the cash redistribution process is considered less relevant in a purely intra-CSD relation, it will have ripple effects when penalties are to be exchanged across CSDs.

Therefore, the following process should be applied:

ASSUMPTION (to be confirmed by ESMA): After the collection process is done (i.e. the CSD collected the amounts from its participants that are not CSDs), the CSD should fulfil its obligations towards the other CSDs[34] by initiating the payment of the monthly amount to be paid to the receiving CSD (see as well reconciliation aspects covered in chapter 9 "Cross-CSD settlement fails"[35]). CSDs should share their penalty cash-account details with the relevant parties (CSDs, cash-correspondents).

10.4 PENALTIES REDISTRIBUTION (CSD TO CSD-PARTICIPANTS)

As soon as the CSD re-distributed the cash amounts due to the other CSDs (if applicable), it should fulfil its obligations towards its other participants that are not CSDs and initiate the payments to re-distribute the cash due to its participants.

It should be noted that:

- CSD participants need to provide their CSDs with the cash-account details on which they will manage their penalties.
- Once a penalty has been paid, it will not be possible to appeal the penalty.

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[33] Single CSDs may allow to use PFOD instructions for this purpose; for cross-CSD payments, this requires prior bilateral agreement amongst the involved CSDs (as not all CSDs may offer PFOD settlement).
[34] Subject to a legal analysis by all CSDs.

[35] In this case, the direct debit functionality – if it exists on the accounts of the other CSD – shall not be used as the CSD to be debited might not have yet fully collected the penalties from its participants, and it would end up with a debit amount on its account (which is not in line with the CSDR).

11   REPORTING

For the purpose of exchanging penalties related information between CSDs and their participants (including those that are CSDs) in a Straight Through Processing fashion, penalties reports content and formats used by CSDs should be harmonised. This is especially relevant in the context of cross-CSD settlement and users being participants of multiple CSDs. Such approach will enable all involved parties to apply a common messaging and communication process, preferably by using ISO standards-based reports.

It is assumed here that the proprietary solutions should not be to report penalties used by CSDs as the (only) communication standards [36] . Proprietary reports could be used as additional communication means, for example to support a participant demand or address market specific aspects.

This Framework chapter focuses on providing a high-level overview of the information to be provided in the respective messages and reports. However, the final specifications will be agreed with and made available by the standards setting organisations.

11.1   REPORTING FORMATS

T2S/4CB has drafted dedicated daily and monthly penalties ISO 20022 reports. Once developed, the relevant 20022 message could also be available to the communities of other CSDs. The existing 15022 message[37] will also be adapted to cover the penalties information.

CSD reports would use the ISO 20022 and /or ISO 15022 messages, when they are made available.This section describes penalty reports, as well as subsequent cash payment-related messages. It should be noted that all reports between CSDs and from CSDs to their participants should be identical in terms of the applied formats.

11.1.1   ISO 20022 messages

For the ISO 20022 format, it is proposed to use a Pillar III semt.018 message dedicated to penalty messaging. The features of this message are as follows:

- It is a message dedicated to penalty reporting and its peculiarities (new information fields);

- It uses the most recent ISO standard in XML format;

- It is to be used as primary message for penalties reporting;

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[36] For the exceptional cases where a CSD may use other standards, please refer to the ESMA Questions and Answers to the CSDR on article 35, CSD Question 4 (a) under the Conduct of business rules. The document can be found here:
https://www.esma.europa.eu/press-news/esma-news/esma-updates-csdr-qas-0
[37] We understand that the adapted MT message may be made available in November 2019. Please refer to the SMPG, **Standards MT Release November 2019, Settlement and Reconciliation.**

- It will have hierarchical blocks, repetitive for every party. These repetitive party blocks will contain repetitive blocks for counterparties, with the specific penalties information (report->party->counterparty->penalty). These repetitive blocks might ease the processing of reports further down the line as they will already contain the needed block of information;

- The proposed message contains fields going beyond the potential group of mandatory fields and can possibly accommodate also optional and additional fields if needed.

11.1.2   ISO 15022 messages

11.1.2.1   Penalties calculation reporting:

CSDs expect that, to address a market demand, ISO 15022 messages will be adapted in a way to cover penalties[38]. The following development of the standard was agreed by SMPG: MT537[39] (Statement of transactions) adaptation would contain a dedicated new sequence specific to the penalties reporting, in order to avoid any rejection of a 'standard' MT537 received after the settlement of the transaction.

It means that MT537 is expected to include new fields and repetitive blocks (such as late matching/ settlement fail; reporting of underlying transaction; penalty ID; credit/debit indicators; calculation parameter references). It is expected that the new fields would correspond to the new ISO 20222 message (semt.018 message) in their content and level.

11.1.2.2   Penalties collection and redistribution (payments) reporting:

CSDs should apply a dedicated message to inform their participants of the actual payment (debit or credit) of the penalties amounts.

Cash pre-advice would be issued by CSD on 15th business day.

The payment advice messages in ISO 150022 format would also be clarified by the standard setting organisation. A confirmation of payment would need to be sent.

11.1.3   User to Application (U2A)
In addition to the above-mentioned messages, CSDs may develop User to Application (U2A) interfaces for the benefit of their participants.

U2A solutions are not covered by this Framework.

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[38] The following Change Requests relevant to the CSDR Settlement Discipline are expected to the implemented through the November 2019 SWIFT release: CR 001449, CR 001446, CR 001463, CR 001447.

[39] MT548 may also be adapted; details will be added once agreed.

11.2 GENERIC REPORTING CONTENT

11.2.1 Information blocks for penalty reporting

The penalty reports will have a hierarchical structure wherein the level within the hierarchy will indicate:

- The level of aggregation;
- The reporting element.

These levels will, in technical terms, correspond to repetitive blocks within the reports, regardless of which ISO format is used.

This way, the high-level report will consist of repetitive blocks, each one representing an individual reporting segment/ level:

T - Technical level

This type of data is of a technical nature stating the specifics of a report. This sort of information falls not strictly within the hierarchical division of provided information.

A - Issuer level (If the non T2S CSD itself manages the calculation process, then this level becomes obsolete)

This level of information provided refers to high-level reports or master reports which are available to CSDs (either produced by themselves or by 3rd parties as in the case of the T2s Penalty Mechanism).

B - Participant level

This level of reporting states information relating to a specific participant (be it a regular participant, CCP, Investor CSD or other).

C - Counterparty/ Penalty level

At this level, a specific participant will be informed within the positions against specific counterparties about the actual penalties. This applies for Daily reports, as well as Monthly reports, with the needed details at penalty and transaction level.

11.2.2 Mandatory fields

Mandatory fields ensure that the recipient of a penalty report will always be able to identify and verify a penalty, i.e. even though he would have to use information from his internal sources.

For example, a penalty report recipient would be informed about the amount of a penalty. In order to identify it, he would need to know:

- The instruction/ transaction ID;
- The day for which the penalty was computed.

In order to verify the penalty, the recipient would need:

- The price of the security;
- The Security penalty rate and/ or the penalty discount rate for the currency;

- The SME Growth Market indicator;
- The Liquidity indicator;
- The amount to which the penalty applies (in case of partial settlements).

However, it will have to be made sure that in a cross-CSD context, the receiving CSD will always be able to allocate the penalty correctly within its community.

Mandatory fields have to comply with the mapping standards of the penalty reporting.

Penalties and penalty aggregates in penalty reports will be always reported in the currency in which they were calculated, i.e. no other conversion will take place except the possible conversion during the calculation process.

For details of currency aspects of calculation see chapters 6 and 7.4.

Mandatory fields (all reports)

Instruction IDs	Account Owner Transaction Identification
	Account Servicer Transaction Identification
Transaction IDs	Processor Transaction Identification
	Market Infrastructure Transaction Identification
	Common Identification
	Related Transaction Identification
	Mutually known transaction identification
Security account number and party identification	Accounts can be layered and there should be assurances that when a CSD states in the penalty report a specific Security account number (and possibly the account owner), that it will be correctly understood by the other CSD (as they might have their own unique account structure).

11.2.3   Payment pre-advices

See chapter 11.1.2.2.

It should be noted that payment pre-advice messages are not (e-)invoices. Therefore, they do not contain the elements listed in Article 6 of EC Directive 2014/55/EU.

11.3   MESSAGE TYPES

There are several types of reporting on penalties throughout the month (see chapter 2 "Penalties Lifecycle and Business Days Calendar"):

1. Daily reporting of penalties;

2. Monthly aggregated reporting of the penalties over the period;

3. Reporting of the amount to be paid/ received;

4. Payment pre-advices which inform about actual payment amounts to be received or paid.

11.3.1   Daily Penalties report

The penalties are calculated and reported for each business day on a gross basis as per point 4 of Article 16 of the final CSDR SDR RTS on Settlement Discipline: "*CSDs shall provide each relevant participant with the details of the calculation of the penalties for each failed settlement instruction on a daily basis, including details on the account to which each failed settlement instruction refers.*".

Penalties are computed for and reported to the relevant **failing and non-failing party**. The CSD will hence report twice each penalty computed:

1. To the failing party (i.e. party imposed with the penalty), and

2. To the non-failing party (i.e. party entitled to receive the penalty).

The **failing party** (party imposed with the penalty) and the **non-failing party** (party entitled to receive the penalty) are the two counterparts responsible for the settlement of the underlying transaction and consequently the respective **owner of the securities account**.

It should be noted that in case of a "cross-CSD scenario" (see chapter 9 "Cross-CSD settlement fails"), the CSD will consider the other involved CSD as the owner of the relevant securities account of the underlying settlement instruction.

The party should be a repetitive block in order to be able to include all the information in a single message.

The CSD should report cash penalties for a given party sorted by counterparty of the penalty (i.e. non-failing or failing party, respectively).

Penalties can be denominated in different currencies. Consequently, the Daily Penalty report should inform penalties reported to a given party sorted per currency.

Each penalty computed for a given business day and reported to the failing/ non-failing party and/ or its CSD should include the details listed in Section 11.2.

It is understood that an individual penalty contained in the report of a specific participant will have a mirror entry (debit vs. credit) in the penalty report of the relevant counterparty, i.e. will be on the participant level reported in two penalty reports.

The daily reports contain only the amounts and information for a specific business day, i.e. they do not reflect exposures accrued in the course of several fail days.

11.3.2   Monthly aggregated report

On the 14th business day of the following month, CSDs should provide the monthly aggregated report (see chapter 7 "Calculation methods of the cash penalties").

This report should include, per currency and party, the bilateral net amounts of the penalties against each of its counterparties, computed for all the business days of the previous month.

12 MISCELLANEOUS

12.1 CONTINGENCY SITUATIONS

12.1.1 Delayed delivery of the reporting

In case a CSD cannot deliver a scheduled report on time (see chapter 2 "Penalties Lifecycle and Business Days Calendar") or at all, it should inform the recipients of its penalty reports.

12.1.2 Non-payment, late or partial payment

[ASSUMPTION to be agreed by ECSDA Board and to be confirmed by ESMA:] To ensure equal treatment of participants and to avoid that CSDs take risks resulting from the management of the settlement fail penalties mechanism incompatible with the CSDR, CSDs should only start distributing penalties when the amounts due are collected in full.

In that case, if collected payments remain on a CSD's dedicated account overnight, any eventual interests should not be used as a source of income but should be deducted from the fees for maintenance of the CSD's penalties mechanism.

CSDs however, ask the authorities to take into account the higher risks of not getting the totality of amounts due (in the exceptional cases) where the CSD does not have a direct debit power over the participants' cash accounts. Furthermore, CSDs ask ESMA to reflect upon the appropriate enforcement measures that CSDs and/or competent authorities could take towards non-paying or late-paying parties.

12.2 CCP-RELATED ASPECTS

12.2.1 CSD participants that are CCPs[40]

Regarding penalties related to participants that are CCPs, the CSDR SDR standards stipulate that CSDs should calculate and report penalties <u>but not actually charge/ credit the calculated penalties</u>.

Hence, CSDs should exclude from their collection and distribution processes the amounts due to be paid and entitled to be received by a CCP as a CSD participant[41].

12.2.2 Penalties calculation and collection process for CCPs

For failing matched settlement instructions involving a CSD-participant that is a CCP, the CSD must calculate and report but not charge the penalties.

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[40] CSDR requests this information to be provided by the CSD participants when applicable; in case the information is not provided for a CCP-cleared instruction, penalties will be calculated <u>and charged</u> by the CSD.
[41] This was informally discussed with ESMA at the settlement discipline workshop on 5 June 2018.

As such, in the CSD processes, CCPs will be included in:

- the computation (daily calculation);
- the daily reporting;
- the monthly aggregated reporting.

The CSD will <u>not</u> include the CCPs that are CSD participants in the following processes:

- reporting of the amount to be paid and to be received; and
- actual payments.

When CCPs regularly cancel all failing instructions after the last settlement cycle has finished, such changes of status and/ or reason after the cut-off must not affect the obligation for the calculation of the penalty, i.e. the (cancelled) failed instructions should be considered for penalties calculation and reporting.

13 ANNEX

13.1 REPORTING

Full file with information files:

Data fields.xlsx

Table 1- List of information fields

Field Business ID*	Information provided	Frequency of reporting**	Presence of information***
T1	Report identification	Di/Dm/M	M
T2	Date and Time of report	Di/Dm	M
T3	Frequency of the report´s delivery	Di/Dm/M	M
T4	Type of report	Di/Dm/M	M
T5	Activity indicator	Di/Dm/M	M
T6	Identification of account servicer/depository	Di/Dm/M	M
T7	Identification of the participant	Di/Dm/M	M
B1	Currency of penalties	Di/Dm/M	M
B2	Aggregated DEBIT Amount	Di/Dm/M	M
B3	Aggregated CREDIT Amount	Di/Dm/M	M
B4	Aggregated Net Amount		?
C1	Identification of the counterparty	Di/Dm/M	M
C2	CSD of the counterparty	Di/Dm/M	M
C3	Net positions against a counterparty	Di/Dm/M	M
C4	Common penalty ID	Di/Dm/M	O?
C5	Individual penalty ID	Di/Dm/M	M?
C6	Type of penalty	Di/Dm/M	M
C7	Status of penalty	Dm	M?
C8	Activity description	Dm	O?
C9	Amount	Di/Dm/M	M
C10	Number of days	Di/Dm/M	M
C11	Calculation Method	Di/Dm	M
C12	Underlying ISIN	Di/Dm	M?
C13	Security subject to penalties	Di/Dm	M?
C14	Financial Instrument Type	Di/Dm	M
C15	Liquidity	Di/Dm	M
C16	SME Growth Market	Di/Dm	M
C17	Security price	Di/Dm	M

C18	Security Penalty Rate	Di/Dm	M
C19	Penalty discount rate for the currency	Di/Dm	M
C20	Penalty Breakdown- Security Side	Di/Dm	M
C21	Penalty Breakdown- Security Side FX Details	Di/Dm	M
C22	Penalty Breakdown- Cash Side	Di/Dm	M
C23	The account owner´s (=participant´s) ID of the underlying instruction	Di/Dm	O?
C24	The account servicer´s (=Issuer CSD´s) ID of the underlying instruction	Di/Dm	M?
C25	The account servicer´s (=Issuer CSD´s) ID of the underlying transaction	Di/Dm	M?
C26	The processor´s ID of the underlying instruction	Di/Dm	M?
C27	The market infrastructure´s (T2S for example) ID of the underlying instruction	Di/Dm	O?
C28	The market infrastructure´s (T2S for example) ID of the underlying transaction	Di/Dm	O?
C29	Common trade reference	Di/Dm	O?
C30	Corporate action ID	Di/Dm	O?
C31	Related transaction ID	Di/Dm	O?
C32	Instructing party identification	Di/Dm	M?
C33	Securities Transaction Type	Di/Dm	M
C34	Intended Settlement Date	Di/Dm	M
C35	Safekeeping Account	Di/Dm	M
C36	Account Owner	Di/Dm	M
C37	Securities Movement Type	Di/Dm	M
C38	Underlying ISIN	Di/Dm	M
C39	Posting quantity- securities	Di/Dm	M
C40	Payment type	Di/Dm	M
C41	Cash account ID	Di/Dm	M
C42	Cash account owner ID	Di/Dm	M
C43	Posting quantity- cash	Di/Dm	M
C44	Settlement finality 1 timestamp	Di/Dm	M
C45	Settlement finality 2 timestamp	Di/Dm	M
C46	Status and reason for fail	Di/Dm	O?
C47	Cut-off identification	Di/Dm	M
C48	Cut-off time	Di/Dm	M
N/A	Fail reason		N/A
N/A	Number of days the penalty is due		N/A
N/A	Legal status of the underlying instruction		N/A
N/A	Legal status of the underlying instrument		N/A
N/A	Cross-CSD transaction		N/A
N/A	VAT regime		N/A
N/A	Business Calendar		N/A
N/A	Primary Trading Venue of Instrument		N/A

N/A	Place of Trading		N/A
N/A	...		N/A

13.2 T2S DOCUMENTS

T2S Penalty mechanism:

t2s penalty
mechanism.pdf

T2S CR654:

t2s_0654_urd.pdf

Penalty lists – Draft message (20022) overview:

t2s_0654_urd_draft
message overview fo

The latest versions of the above documents can be found on the ECB website:

https://www.ecb.europa.eu/paym/t2s/governance/tg/html/crg.en.html

List of CSDR items for clarification sent to ESMA:

2017-06-28 - List of
CSDR Items for clarif

13.3 OTHER DOCUMENTS AND REFERENCES

Link to ESMA website re. CSDR:

https://www.esma.europa.eu/regulation/post-trading/settlement