EUROPEAN CENTRAL BANK
EUROSYSTEM

TARGET2-SECURITIES

DIRECTORATE GENERAL MARKET INFRASTRUCTURE AND PAYMENTS

ECB-UNRESTRICTED

10 January 2017
DRAFT

LIST OF CSDR ITEMS FOR CLARIFICATION

Note: Items marked in yellow represent assumptions which the ECB considers to be stable

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
1	**Joint management of cash penalty mechanism**	Article 7(15) Measures to address settlement fails	Article 19 CSDs that use a common settlement infrastructure - ESMA/2016/174 Final Report Draft regulatory technical standards on settlement discipline	CSDs that use a common settlement infrastructure, including in the circumstances referred to in Article 30(5) of Regulation (EU) No 909/2014, **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	The stable working assumption is that when CSDs use a common settlement infrastructure, the entire penalty mechanism should be jointly managed. It is thus expected that the calculation, application, collection and redistribution of cash penalties would be jointly managed. If multiple service providers are used, it is up to the CSDs using a common settlement infrastructure to prove how they can ensure the joint management of the penalty mechanism, in particular with regard to the coordination and exchange of information between the different service providers. We ask your views on the two different options for implementation:

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				with Regulation (EU) No 909/2014.	1. T2S CSDs manage and operate it jointly (single service provider option) 2. T2S CSDs manage **BUT do not** operate it jointly (multiple service providers option) In the second case, what is the regulatory expectation of how exactly the T2S CSDs need to "jointly manage" the cash penalty mechanism beyond what is already determined for all EU CSDs in the Regulation? In particular, is a joint decision by those CSDs on the modalities of the mechanism sufficient, without the need for a joint operation of the mechanism? There is no guarantee that the non-T2S, but still EU, CSDs will also follow absolutely the same harmonised conversions/parameters as the CSDs participating in the jointly managed cash penalty system. Thus there is a risk of different outcome for calculation of penalties between T2S and non-T2S CSDs unless absolutely all elements are harmonised at EU level and not only at T2S level.
2	**Types of Financial Instruments for review and**	Article 29 (3) (4) Record Keeping	Article 43 (d) (i) Statistical data to be delivered for each review and evaluation, Annex II: Templates for	For each review period, the CSD shall provide the competent authority with the following statistical data: […]	1. The codes for the types of financial instruments laid out in Draft Technical Standards under CSDR are not in line with those described by the ISO CFI10962:2015 (6 characters). However, our

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	evaluation of CSDs / reporting of settlement fails and ISO CFI10962:2015 standard compliance		submission of information for the review and evaluation Table 3 Statistical data, id 4 & Article 13 (1) (c) Details of the system monitoring settlement fails - ESMA/2015/1457/Annex II Annex II to the Final Report on the draft technical standards under CSDR (CSD requirements and internalised settlement) & ESMA/2016/174 Final Report Draft regulatory technical standards on settlement discipline	(d) the nominal and market value of the securities referred to in point (c) divided as follows [...]: (i) by type of financial instruments, as follows [Format laid out as in Annex II Table 3]: a) SHRS (**or more granular codes as provided by the CSD**) - transferable securities referred to in point (a) of Article 4(1)(44) of Directive 2014/65/EU b) SOVR (or more granular codes as provided by the CSD) - sovereign debt referred to in Article 4(1)(61) of Directive 2014/65/EU; c) DEBT (or more granular codes as provided by the CSD) - transferable securities referred to in point (b) of Article 4(1)(44) of Directive 2014/65/EU, other than those mentioned under point b); d) SECU (or more granular codes	understanding is that there is some flexibility provided by ESMA as regards the usage of codes: "or more granular codes as provided by the CSD". Do you agree that the mapping of CSDR instrument categories and CFI codes produced by the T2S CSDR Task Force (see Excel file circulated on the 7th of June) can constitute a good basis for ensuring compliance with the CSDR while allowing for standardised and consistent recordkeeping of all asset types by CSDs? Remark: the mapping is not always obvious (e.g. for emission allowances no corresponding category under ISO CFI10962:2015 standard). To ensure consistent reporting, we would see a value in keeping a CFI/CSDR mapping table (based on the file previously circulated) publically available. We would expect CSDs to collectively work on a rulebook and to ensure that this rulebook is maintained centrally and updated as appropriate. This will ensure a consistent implementation across all EU CSDs.

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				as provided by the CSD) - transferable securities referred to in point (c) of Article 4(1)(44) of Directive 2014/65/EU; e) ETFS (or more granular codes as provided by the CSD) - exchange-traded funds (ETFs); f) UCIT (or more granular codes as provided by the CSD) - units in collective investment undertakings, other than ETFs; g) MMKT (or more granular codes as provided by the CSD) - money-market instruments, other than those mentioned under point b); h) **EMAL (or more granular codes as provided by the CSD) - emission allowances;** i) OTHR (or more granular codes as provided by the CSD) – others by country of incorporation of the participant (ISO 3166 2 character	

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				country code)/ country of incorporation of the issuer (ISO	
2.1	Same as above	Same as above	Same as above + Delegated Acts of 11.11.2016 on CSDR preamble (7)	Delegated Acts of 11.11.2016 on CSDR preamble (7) The level of cash penalties for settlement fails of transactions in debt instruments issued by sovereign issuers should take into account the typically large size of these transactions and their importance for the smooth and orderly functioning of the financial markets. Settlement fails should therefore be subject to the lowest penalty rate. Such a penalty rate should nevertheless have a deterrent effect and provide an incentive for timely settlement.	**Illiquid shares:** Our working assumption is that a list of illiquid shares (according to MIFID/MiFIDR) on a regular basis and in a machine-readable format. Would ESMA be in a position to provide such list? **Liquid Shares:** Our working assumption is that all shares which are not in the above list, could be considered as liquid shares. (Or will ESMA provide information on a list of liquid shares?) **SME growth markets:** We understand that an instrument which was traded on an SME growth market as defined under the MiFID (a MTF that is registered as an SME growth market in accordance with Article 33 of MiFID II) shall incur penalties according to the penalty rate for SME growth markets, except in the case of debt instruments issued by sovereign issuers (SOVR), which should be subject to the lowest penalty rate according to the Delegated Acts of 11.11.2016 preamble (7). Please could you clarify which of the following options

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					would apply if the same instrument would be also traded in another (non SME growth market MTF)?: 1) It shall also incur the SME growth market penalty rate or 2) it shall incur penalties according to the other classification of instruments. ***Option 1*** *would mean that if an instrument is listed on any SME growth market MTF, its classification would take the highest priority over all other financial instrument classifications, independently on whether the particular trade has actually taken place on the SME growth market MTF or not. This option has the advantage of facilitating automation (a given ISIN will always be subject to the same penalty rate, irrespective of the place of trading) and would avoid creating distortions among venues (especially given that a single settlement instruction in the same SME growth market share could potentially reflect multiple trades on both SME growth markets and "standard" trading venues). In particular this approach would be in line with the immunization principle suggested by ESMA to protect CSD participants from differences in penalties (and*

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					thereby negative consequences) which enable its clients to trade securities on different exchanges. *This approach would also be in line with the best-execution approach for client orders if orders can only be partially executed on one exchange.* ***Option 2** would mean that only instructions which have been actually traded on an SME growth market MTF, will incur penalties pertaining to SME growth markets.* *The CSDR text seems to suggest option 1, and we would like to validate this understanding.* **Money market/short term papers:** Our working assumption is that a short term paper issued by non-public bodies is meant to be included in the "Corporate bonds" category (whereas money market instruments issued by public authorities fall under the category "Government and municipal bonds"). **UCIT category:** Is there an intention by ESMA/the Commission to restrict this category to UCITS authorised funds? (Would non-authorised funds such

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					as alternative investment funds, real estate funds, etc… fall under the category "OTHR")? **Definitions:** For UCIT, MMKT and EMAL, there is currently no definition provided. Would the intention be, to add a reference to point (3) of Section C of Annex I to Directive 2014/65/EU, as was done in the CSDR Level 1? **SOVR:** Our working assumption is that supranational debt (e.g. EIB and World Bank bonds) should be included. Is this the case?
3	**Discrepancy between types of Financial Instruments for review and evaluation of CSDs / reporting of settlement fails and asset classes**	Article 7(2) Measures to address settlement fails	2.49 Penalties for Settlement Fails (page 15) - ESMA/2015/1219 Technical Advice under CSDR	… in order to limit the number of categories of rates to apply for automation reasons, ESMA considers as appropriate the following levels for the calculation with regard to the penalty rates: **Asset Type/liquidity - Daily flat penalty rate** **Liquid shares - 1.0bp**	CSDs are required to report their settlement fails to the regulators using a differentiation of assets classes based mostly on the definitions contained in Directive 2014/65/EU. At the same time, in the table on p.15 of ESMA's technical advice on penalties for settlement fails, which is to be used for calculating penalties, there is a different categorisation of assets classes. We think that this inconsistency should be remedied so that the different categories of asset classes

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	for calculating cash penalties			**Illiquid shares and others financial instruments (such as ETF, certificates, DR, etc.) - 0.5bp** **SME Growth Market shares and other financial instruments - 0.25bp** **Corporate bonds - 0.20bp** **SME Growth Market bonds - 0.15bp** **Government and municipal bonds - 0.10bp** **Cash - Discount Rate per currency with a floor of 0**	identified when monitoring settlement fails could be used, ideally, directly or after some straightforward transposition for the purpose of calculating penalties and/or reporting settlement fails. Would it be possible to consider adding a clarification on the asset types, based on the CFI/CSDR mapping table (and our working assumptions described in Item 10), in the Q&A or potentially in the Level 2 text?
4	**Matching tolerance levels**	Article 6 (5) Measures to prevent settlement fails	Article 6 Tolerance levels - ESMA/2016/174 Final Report Draft regulatory technical standards on settlement discipline	For the purpose of matching settlement instructions, a CSD shall set tolerance levels for settlement amounts. The tolerance level shall represent the maximum difference between the settlement amounts in two corresponding settlement instructions that would still allow	The stable working assumption is that, with regard to the issue of how often the exchange rate used to determine the tolerance level per settlement instruction in other currencies than EUR (referred to in Article 6 of the RTS on Settlement Discipline) should be updated, it is considered that it should be updated annually. To ensure consistency across CSDs, they should use the same exchange rates. In this respect, the official exchange rates of the ECB,

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				matching. For settlement instructions in EUR, the tolerance level per settlement instruction shall be 2 EUR for settlement amounts of up to 100 000 EUR, and 25 EUR for settlement amounts of more than 100 000 EUR. For settlement instructions in other currencies, the tolerance level per settlement instruction shall be of equivalent amounts **based on the official exchange rate of the ECB**, where available.	where available, valid on 1 January of the respective calendar year, would be the appropriate reference. The Technical Standards do not prescribe a specific periodicity for the actualisation of such rates. Our working assumption is that the periodicity can be defined as deemed practical by CSDs, e.g. yearly. Can you confirm there is reasonable flexibility as to how often to update the exchange rate?

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5	**Failing settlement instruction (PENF)**	Article 29 (3) (4) Record Keeping	Article 54 (2) Transaction/Settlement Instruction (Flow) Records Annex IV: Format of CSD records, Table 1 - Transaction/settlement instruction (flow) records, id 21 - ESMA/2015/1457/Annex II Annex II to the Final Report on the draft technical standards under CSDR (CSD requirements and internalised settlement)	Annex IV: Format of CSD records, Table 1, id 21 Field: Status of settlement instructions - Format: PEND – Pending instruction (settlement at the ISD is still possible) **PENF – Failing instruction (settlement at the ISD is no longer possible)** SETT – Full settlement PAIN – Partially settled CANS – Instruction cancelled by the system CANI – Instruction cancelled by the participant	**CSDR TF additional feedback 21/04:** The CSDR TF noticed that in the published CSDR Q&A (31 March 2017), a slightly modified version of the cut-off time has been used as compared to the below, with the introduction of the term "agent bank" "The cut-off time is the deadline set by a system or an agent bank for the acceptance of transfer orders for a given settlement cycle, for the relevant settlement instructions, i.e. there could be different cut-off times for different settlement instructions." The CSDR TF is of the opinion that the inclusion of the term “agent bank” in the definition could lead to misunderstandings, i.e. that different points in time would be applied for the decision whether or not an instruction becomes failing (e.g. agent cut-off is 15:45h, T2S cut-off 16:00h). We believe the "system" (T2S or CSDs) deadline shall be the only relevant cut-off time for the application of penalties. Hence, we propose that either: (i) the reference to "agent bank" shall be removed in the CSDR Q&A, or; (ii) that a further clarification is brought to the Q&A that for the application of penalties, the only

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					relevant cut-off time is the one of the system calculating the penalties (i.e. T2S or CSD). The stable working assumption is that Settlement instructions are considered as 'failing settlement instructions' from the moment when settlement at the Intended Settlement Date (ISD) is no longer possible, i.e. if they are still pending on the ISD after the settlement processing related to the respective settlement instructions submitted by the relevant cut-off time has been completed. The cut-off time is the deadline set by a system for the acceptance of transfer orders for a given settlement cycle, for the relevant settlement instructions, i.e. there could be different cut-off times for different settlement instructions. To illustrate, in T2S, the standard DVP cut-off is 16:00 and the FOP cut-off is 18:00, which means that T2S accepts settlement instructions until this cut-off attempts their settlement at least once if they are eligible. If e.g. the settlement processing related to standard DVP cut-off finishes at 16:02, that point in time shall be the trigger for flagging the

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					corresponding settlement instructions as "Failing" (PENF). Note that the notion of cut-off time is also deemed essential in the design of the settlement penalty system. Indeed, for the purpose of determining which settlement instructions are subject to a penalty, a "snapshot" of the status of failing settlement instructions should be taken directly after the settlement processing related to the relevant cut-off has been completed. This ensures that changes to the status of the instruction occurring after completion of the settlement processing related to the relevant cut-off, such as cancellations, are disregarded. The particular business scenario of end of day cancellations is relevant for CCPs that cancel failing settlement instructions of a specific business day in order to net them with the settlement instructions due to settle the following day[1]. The CSDR TF has identified the need to ensure that such settlement instructions, that CCPs would cancel for the purpose of this netting process[2] before the settlement

[1] This process is called Settlement Date Netting at Eurex Clearing, and Continuous Net Settlement for LCH Clearnet

[2] Not to be confused with bilateral cancellations performed by CSD participants for non-cleared transactions.

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					processing related to the relevant cut-off has been completed, fall within the scope of penalties, as they would not be identified as such by the settlement penalty mechanism.

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6	**Obligation to report LEI for CSD's counterparty**	Article 29 (3) and (4) Record Keeping	Article 11 (1) and (5) Format of Records & Annex IV: Format of CSD records, Table 1 - Transaction/settlement instruction (flow) records, id 14	Article 11 (1) A CSD shall retain the records referred to in Article 54 of Regulation (EU) No… [RTS on CSD requirements], for all transactions, settlement instructions and orders concerning settlement restrictions that it processes, in the format set out in Table 1 in Annex IV to this Regulation. Article 11 (5) A CSD shall use a legal entity identifier (LEI) or a bank identifier code (BIC), with the obligation to convert to LEI for the purposes of reporting to authorities to identify in its records: (a) a CSD; (b) CSD participants; (c) settlement banks; (d) issuers.	Issue: It is not clear whether CSDs need to know the LEI for participants in OTHER CSDs (i.e. counterparts of their participants in a cross-CSD transaction). Argumentation: The reporting in the context of the review of the CSD is outlined in Annex II, and therefore only requires the reporting of the (all) CSD's participants and not of CSD participants' counterparts (Annex II table 3 item 1). However, in line with Art.29.2 CSDR/Art.41.1.c RTS/Art.53.3 RTS, the competent authority may require the submission of the 'recorded' data as well. Article 11(5) on LEI refers to CSD participants (hence suggesting that the obligation to convert BIC to LEI applies to a CSD's own participants) while the parenthesis in Annex IV on record keeping suggests a CSD needs to know the LEI of ALL the participants of the CSDs with which it has links, hence making the requirement more costly to meet for CSDs with more cross-border activity.

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				& Annex IV: Format of CSD records, Table 1 - Transaction/settlement instruction (flow) records, id 14 : **Identifier of the instructing participant's counterparty** ISO 17442 Legal Entity Identifier (LEI) 20 alphanumerical character code, or Bank Identifier Code (BIC) **(with the obligation to convert to LEI for the purposes of reporting to authorities)**	Impact: While CSDs should ensure to keep within their data bases the LEI of those with whom they have a contractual relation, if the requirement to translate to LEI is extended to parties with which they have no contractual relationship, they cannot ensure that their data bases will contain this information. Hence it imposes on CSDs the use of an external provider of translation to LEI services, reducing the incentive to keep an internal LEI database.

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7	**Quantity or nominal amount of securities records**	Article 29 (3) and (4) Record Keeping	Annex IV: Format of CSD records, Table 1 - Transaction/settlement instruction (flow) records, id 20	Annex IV: Format of CSD records, Table 1, id 20: Quantity or nominal amount of securities: Up to 20 numerical characters **reported as whole numbers without decimals.**	The stable working assumption is that CSDs can record the quantity / nominal amount of securities with decimals, i.e. with a higher granularity, provided that when they report this data to authorities they do so without decimals (using the "truncate" approach). The Technical Standards foresee the reporting of quantity or nominal amount of securities without decimals. However, in T2S securities quantities are stored and reported with decimals, as supported by ISO20022. It is understood as a market-wide practice which is in some case backed up by business needs, e.g. in the context of fund shares.

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8	**Partial settlement indicator**	Article 29 (3) and (4) Record Keeping	Annex IV: Format of CSD records, Table 1 - Transaction/settlement instruction (flow) records, id 21	Annex IV: Format of CSD records, Table 1, id 21 Field: Status of settlement instructions - Opt-out of partial settlement Possible values: NPAR if opt-out of partial settlement is activated **BLANK if partial settlement is allowed**	The stable working assumption is that CSDs can keep more granular records, but, when reporting to authorities, they should use the format specified in the ITS on CSD Requirements. The Technical Standards foresee the reporting of a BLANK value if partial settlement is allowed. In T2S, other values can be inputted/interpreted by T2S if partial settlement is allowed: PART, PARC, PARQ. These are stored as such in the T2S database and reported to clients. Details as follows: PART – Partial settlement allowed PARQ – Partial settlement quantity threshold allowed PARC – Partial settlement cash threshold allowed

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9	**Scope of financial instruments subject to penalties**	Article 2- (8) Definitions Article 5(1) Intended settlement date Article 7(10) – Measures to address settlement fails	CSDR Q&A (3 October 2014), point 16	Article 2 - Definitions (8) **'financial instruments'** or 'securities' means financial instruments as **defined** in point (15) of Article 4(1) of Directive 2014/65/EU (i.e. **MiFID**); Article 7.10 - CSDR: [...] Paragraphs 2 to 9 shall apply to all transactions of the financial instruments referred to in Article 5(1) which are admitted to trading or traded on a trading venue or cleared by a CCP […] […]13. This Article 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**	Issue: The rules to determine the scope of financial instruments subject to penalties has been largely clarified with the CSDR Q&A. The issue that CSDs and market participants are facing is rather how to ensure consistent application of the above rules, and in particular how to check whether the financial instruments referred to in Article 5(1) are admitted to trading or traded on a trading venue, or cleared by a CCP. ESMA provides a public register of financial instruments under MiFID. For the purpose of the Article 16 of the Short-Selling Regulation, ESMA also provides list of exempted shares for which the principal trading venue is located in the third country. In order to ensure a fair application of the penalty regimes across the EU, a centralised and single source of information for instruments subject to penalties is deemed necessary. Question: The question is whether ESMA would provide such list of instruments for the purpose of CSDR, i.e. the list of relevant MiFID financial

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				236/2012 (i.e. Short-Selling Regulation). CSDR Q&A (16): Article 7(10) provides that the **settlement discipline measures** referred to in Article 7(2) to (9) **apply to financial instruments referred to in Article 5(1) (i.e. transferable securities, money-market instruments, units in collective investment undertakings and emission allowances)** that are: a) admitted to trading on trading venues (OTC transactions) ; or b) traded on a trading venues (non-OTC transactions)5 ; or c) cleared by a CCP (OTC and non-OTC transactions regardless of whether the financial instruments are or not admitted to trading on trading venues)6 .	instruments admitted to trading or traded on a trading venue, or cleared by a CCP, excluding the shares for which the principal trading venue is located in a third country. In the case where ESMA is not providing such list, we would request detailed guidance on the approach to be followed in order to ensure consistent identification of instruments subject to penalties. Please also note that having an estimate of the number of financial instruments in scope of penalties would facilitate making volumetric assumptions which are seen as critical for the design/implementation of the penalty system.

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				Article 7(10) therefore excludes from the scope of application of Article 7(2) to (9), transactions in financial instruments that are not admitted to trading and not cleared by a CCP.	

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10	**Asset type classification and applicable rate (basis points) for calculation of penalties**	Article 7 Measures to address settlement fails	Technical Advice under CSDR (ESMA/2015/1219) - 2.1.2 The penalty rate , point 49 (page 15) Delegated Acts of 11.11.2016 on CSDR preamble (7)	[…] in order to limit the number of categories of rates to apply for automation reasons, ESMA considers as appropriate the following levels for the calculation with regard to the penalty rates: **Asset Type/liquidity - Daily flat penalty rate** **Liquid shares - 1.0bp** **Illiquid shares and others financial instruments (such as ETF, certificates, DR, etc.) - 0.5bp** **SME Growth Market shares and other financial instruments - 0.25bp** **Corporate bonds - 0.20bp** **SME Growth Market bonds - 0.15bp** **Government and municipal bonds - 0.10bp** **Cash - Discount Rate per currency with a floor of 0**	Our main working assumption is that the "Asset type/liquidity" classification made for the purpose of defining applicable rate (basis points) for calculation of penalties is derived according to 3 criteria for financial instruments: 1. **Type of financial instrument**, as referred to in Item 2 of the current list (e.g. "SHRS", "SOVR", etc…). A type of instrument can be derived for each ISIN when the proposed mapping between CFI and types of instruments (version circulated on the 7th of June) is fully clarified and validated by ESMA. Once completed, such mapping table should ideally be published (possibly as part of Q&A?) and used as a rulebook across EU CSDs. 2. **Liquid/illiquid character of shares**, as referred to in Item 2.1 of the current list. The working assumption to confirm has been that ESMA will provide a list of liquid and/or illiquid shares. **Additional question**: what is the envisaged frequency for publishing an updated list, e.g. quarterly or annually?

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				Delegated Acts of 11.11.2016 on CSDR preamble (7) The level of cash penalties for settlement fails of transactions in debt instruments issued by sovereign issuers should take into account the typically large size of these transactions and their importance for the smooth and orderly functioning of the financial markets. Settlement fails should therefore be subject to the lowest penalty rate. Such a penalty rate should nevertheless have a deterrent effect and provide an incentive for timely settlement.	3. **SME growth market securities**, as referred to in Item 2.1 of the current list. The working assumption to confirm has been that a security that is listed under an MTF registered as SME growth market by its home competent authority will incur penalties according to the penalty rates defined for SME growth markets, independently of whether it is also listed elsewhere, or also belonging to another rate category, e.g. illiquid shares, except in the case of debt instruments issued by sovereign issuers (asset type "Government and municipal bonds"), that should be subject to the lowest penalty rate according to the Delegated Acts of 11.11.2016 on CSDR, preamble (7). The list of MTFs registered as SME growth market is available in the public ESMA register. **Additional question**: what is the envisaged frequency for publishing an updated list, e.g. quarterly or annually?

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11	**Scope of instructions subject to penalties**	Article 7.15 Measures to address settlement fails Article 2(9) Definitions	Technical Advice under CSDR (ESMA/2015/1219) - 2.1.1 The basis for the cash penalty calculation (point 19, 20, 21) Article 16 Collection of cash penalties & Article 1(f) Definitions - ESMA/2016/174 Final Report Draft regulatory technical standards on settlement discipline	*Article 16* *Collection of cash penalties* 1. The cash penalties shall be calculated and applied by the CSD **for each settlement instruction that fails to settle**. For the calculation of cash penalties, settlement instructions that fail to settle shall be deemed to include settlement instructions that have been put on hold by a participant. *Article 1(f)* *Definitions* […] **'settlement instruction' means a transfer order** as defined in point (i) of Article 2 of Directive 98/26/EC of the European Parliament and of the Council; Technical Advice under CSDR - 2.1.1 The basis for the cash penalty calculation	We understand that the CSDR does not grant a mandate for ESMA to further determine through RTS the scope of application of the penalty mechanism and that, according to the CSDR, all failed settlement instructions are subject to penalties. We also support the principle that different transaction types should not lead to different penalty rates in order to have a consistent application of penalties in the context of chain of fails. However the scope of the settlement penalties seems restricted to "transfer orders", as referred in CSDR Level 1 Article 2 and CSDR Level 2 (ESMA/2016/174) Article 1 and Article 16. We would like to confirm the understanding whether the definition of "transfer orders" should be used as a basis to define the scope of instructions subject to penalties. This would allow for a selective approach for the application of the penalties, based on a core concept defined in the SFD, while remaining transaction "agnostic". After analysis, the view of the CSDR TF is that the following transactions should be considered out of scope of settlement penalties:

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				The category of transactions 19. Most of the settlement instructions do not include information on the category of transaction they relate to. Indeed, the instruction does not indicate whether the underlying transaction is for instance a loan of financial instruments and part of a larger operation. 20. Furthermore, in the context of chains of fails, the transaction type may introduce a different penalty depending on the type of transaction and could create imbalances between the different parties in the chain limiting the	• Corporate Actions on stock[3], and potentially market claims (which are a type of Corporate Actions on flows) • Settlement instructions generated by T2S, inter alia realignment and auto-collateralisation instructions, since they are not initiated by participants. As regards market claims, the CSDR TF has identified that the application of a late matching fail penalties would, in some cases, be applied to the wrong participant: indeed, the participant causing the late matching of the underlying transaction, and therefore the late generation of market claim, would be the beneficiary of the late matching fail penalty on the market claim. A case by case analysis should be performed by CSDs for each transaction, in order to determine whether the penalty should be passed on to

[3] From a literal interpretation of the definition of the term „transfer order" ("*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*") it may be questionable whether CAs would not qualify as such. A potential line of argumentation could be that with CAs, money and/or securities come from the issuer which is (most likely) not a system participant. However, the issuer usually has some representative within the system (the CSD itself or a cash settlement agent), so that the representative would then be the subject penalty (which would then have to revert to the issuer to be refunded. Thus, it does appear possible that CAs are covered by the sanctioning regime. Nevertheless, the "out of scope"-result appears to be correct, as we hold the view that the application also to CAs would go beyond the legislative intent.

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
				mitigating effect of the redistribution of the penalties. 21. In view of the above, ESMA is of the view that **the category of underlying transaction to which the settlement instruction relates should not lead to different penalty rates**.	the counterparty. As the late instructing participant would already be penalised for the late matching of the underlying instruction, Hence, the CSDR TF would be in favour of exempting market claims from the application of late matching fail penalties, which would also preserve CSDs from a complex reconciliation process. All other transaction types should in principle be considered in scope: • Other Corporate Actions on flows, i.e. transformations[4]. • Primary market (Issuance) operations, except in a very specific case[5]. The proposed approach entails that there is no or minimal deviation in the transposition of the SFD into national laws as regards the scope of "transfer orders", but represents a harmonised approach with the buy-in regime under CSDR.

Deleted: Some TF members proposed to take the reasoning further and to also exempt market claims for the application of settlement fail penalties, on the basis that market claims are only generated due to non-timely settlement of the underlying transaction for which a penalty will already be due.

[4] Process by which pending transactions still unsettled by the end of Record Date / Market Deadline, are cancelled and replaced in accordance with the terms of the reorganisation

[5] i.e. Those transactions where there is pre-funding of the capital increase or debt offering, and 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.

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
12	**Application of settlement penalty in case of insolvency**	Article 7.15 Measures to address settlement fails	None	Article 7 - Measures to address settlement fails 12. Paragraphs 2 to 9 shall not apply if insolvency proceedings are opened against the failing participant.	**Note that a dependency has been identified between this Item and Item 19 "Calculation of net amounts for collection and redistribution of penalties":** indeed, the timing and scope of exemption in case of insolvency of a CSD participant will impact the collection and redistribution process, to different degrees depending on the model implemented for the latter (see description of the different options under Item 19). We would like to confirm our understanding of the legal text according to which failing settlement instructions of a participant that has been declared under insolvency proceedings shall not incur any settlement penalty, as from the point in time in the securities settlement system corresponding to the calendar date and time where the insolvency is declared[6]. As the CSD only redistributes penalties that it has collected, it would not have any exposure to the insolvency of the participant.

[6] Calendar date and business date may differ

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					Furthermore, to safeguard CSDs from financial risk, it is understood that the CSD itself shall not be obliged to lodge towards the insolvent participant the potential claim for the period preceding the opening of the insolvency procedure. Claims shall be lodged directly between CSD participants. An additional clarification is requested as for the point in time of the exemption. The interpretation can be that: 1. Exemption is from the moment the insolvency is declared, for all settlement instructions still in the system, including those which were entered before the declaration of insolvency (i.e. would be protected from a SFD viewpoint). 2. Exemption is for settlement instructions inputted after the insolvency is declared, that means that settlement instructions that would be entered prior to the moment of insolvency and which would still be failing when/after the insolvency is declared would not benefit from the exemption. 3. Exemption is for all penalties incurred during the month where the insolvency is declared.

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					The rationale for this third option is the low probability of these penalties ever being paid. While it can be anticipated that CSDs will at some point create a penalty bill (usually being done at the end of the month), such claim will come at a late stage in the insolvency process. When the claim is received, the insolvency practitioner will likely consider it no less or more important than other claims, i.e. the practitioner would probably decide to wait for any payments to be done and the CSD would not receive the full amount of penalties that are to be distributed. Taking out all penalties for the "complete penalty bill" cycle would enable the CSD to keep a balanced collection and re-distribution mechanism. Furthermore, is this exemption only valid for penalties which are due, or also penalties to be received, i.e. is an insolvent participant still entitled to receive the proceeds of a penalty due to the failure of its counterparty? The CSDR TF has identified that allowing an insolvent participant to receive the proceeds of penalties could create imbalances and complexities in the penalties collection and redistribution process. This would in particular be true

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					in the situation where on one side the participant is failing to deliver (which would not be penalised) due to a failing receipt (for which it would receive the amount due). With the understanding that buy-in should not be triggered for an insolvent participant, the CSDR TF is not in favour of option 2. If option 2 is favoured, should the extension period be taken into consideration for the maximum number of days to apply the penalty? Furthermore, while the second option would be in line with the insolvency procedures defined in T2S as regards the Settlement Finality Directive and protection of transfer orders, there would also be a number of drawbacks taking this approach: penalty fines would keep on adding on a participant that is insolvent and has possibly no more access to its securities accounts / cash accounts at the CSD. Furthermore, from an insolvency law perspective, the ECB Legal Team is of the preliminary view that from the moment where the insolvency is declared, the debt against the insolvent entity cannot be created (subject to certain exceptions as for fees for the management of the insolvent estate). Therefore, any debt that takes

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					place following the opening is most likely not admitted in the insolvency estate, e.g. cannot be recovered.

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
13	**Cross-border settlement penalty reconciliation**	Article 7.15 Measures to address settlement fails	Technical Advice under CSDR (ESMA/2015/1219) - 2.3 Parameters for the calculation of cash penalties in the context of chains of interdependent transactions, point 60	*2.3 Parameters for the calculation of cash penalties in the context of chains of interdependent transactions* […]60. For this reason, it is important that the balance between **the amount collected and distributed** as proposed in the RTS be maintained, and **be similar across the different structures involved in the penalty mechanism**. As a result, the parameters for the calculation of the penalties should not be modified in order to address the situation of chains of interdependent transactions.	As different settlement penalty systems and data providers may co-exist in the EU, it cannot be excluded that there will be variations in the amount of the calculated penalty in case of cross-border transaction where the CSDs use different settlement penalty systems, as the reference prices used may slightly differ. Our proposed approach in this case would be to follow the calculation performed by the Issuer CSD, since the Issuer CSD supposedly has the most accurate and up-to-date reference data for the securities incurring a penalty. The CSDR TF would NOT be in favour of defining a tolerance amount in case of differences in the calculation of a penalty, as, in the case of chain of transactions, this would; (i) not ensure the 'immunisation principle', as referred to in the RTS on Settlement Discipline, for participants which are not at the end of the chain and; (ii) complexify the reconciliation process, with the need to consider the reference penalty from the Issuer CSD and check tolerance amounts down the chain. Furthermore, a particular scenario was discussed in the T2S CSDR TF: shall a penalty be due in case of

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					transaction with a non-European CSD (not subject to CSDR)? Two scenarios can be distinguished: • The non-European CSD is acting as Issuer CSD. The ISIN would not necessarily fall out of scope of the CSDR, if the EU is the principal trading venue for a non-EU ISIN OR the non-EU ISIN is cleared by a European CCP? • The non-European CSD is acting as Investor CSD. Here our initial assumption would be that, since the non-European CSD is acting as a participant of a CSD subject to CSDR, the penalties de facto apply to that non-European CSD. However, this would cause practical problems, i.e. as the non-European CSD's underlying customers are not bound by EU CSDR.

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
14	**Application of VAT to settlement penalties**	Article 7.15 Measures to address settlement fails	Article 16.5 - Collection of cash penalties - ESMA/2016/174 Final Report Draft regulatory technical standards on settlement discipline Technical Advice under CSDR (ESMA/2015/1219) - 2.3 Parameters for the calculation of cash penalties in the context of chains of interdependent transactions, point 58	A CSD shall charge and collect at least monthly the net amount of cash penalties to be paid by each participant *2.3 Parameters for the calculation of cash penalties in the context of chains of interdependent transactions* 58. In order to effectively reduce the number of failed instructions, and improve settlement efficiency in the Union, the focus of the penalty regime should be to dis-incentivise the original fails, which are the root cause of the issue. This is best achieved by designing a penalty mechanism where penalties are paid by the failing party and are received by the non-failing party. Such a mechanism should be effective in targeting participants which fail to deliver the securities on ISD, and	Is VAT applicable to the settlement penalties or are they tax exempt? In the former case, are the rules and rates of each national market prevailing or would there be a common EU rule and rate? Our working assumption goes towards global exemption of VAT for settlement penalties (or alternatively a common EU rate) for the following reasons: 1. This would ensure that no EU market has a competitive advantage because of lower VAT rates 2. This would ensure that the penalties are offset in the case of chain of failing transactions for participants which are not at the end of the chain 3. This would be in line with the fact that the penalties are of sanctioning nature and do not constitute a payment for provided services

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
				which should be fully subject to the penalty**, but should also immunize participants that are failing because they are being failed in turn, because the penalty due would be offset by the penalty received**.	

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
15	**Calendar to be applied to identify business days for penalty calculation**	Article 7 Measures to address settlement fails	none	-	Could you please confirm our working assumption? The general principle is that T2S settlement calendar will be used for T2S penalty system. However, in case of transactions involving settlement outside T2S, be it when the Issuer CSD is outside T2S, or when the settlement of the cash leg happens outside T2S, the common opening days of the respective calendars must be used, i.e. a penalty shall not be due for the days where a transaction cannot settle. For example, in case of a cross-CSD transaction between a CSD in T2S and a CSD outside T2S (Issuer CSD), a penalty shall not be due in T2S for the days where settlement at the Issuer CSD is not possible (i.e. closing day for settlement in that particular CSD). That principle shall be applicable for CSDs outside T2S, i.e. for their domestic transactions, their own calendar must be used, while as for cross-CSD transactions, the "common" calendar must be used. For T2S, we would implement a "Penalty update management function", which CSDs could use to correct to cases ex post.

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
16	**Status of instructions in scope of penalties**	Definition of "settlement fail"	ESMA RTS Settlement discipline: Article 16 - Collection of cash penalties	Definition of settlement fail (CSDR L1): 'settlement fail' means the non-occurrence of settlement, or partial settlement of a securities transaction on the intended settlement date, due to a **lack of securities or cash and regardless of the underlying cause**; Article 16 - Collection of cash penalties: The cash penalties shall be calculated and applied by the CSD for each settlement instruction that fails to settle. For the calculation of cash penalties, settlement instructions that fail to settle shall be deemed to include settlement	The current assumption in the CSDR TF is that all live[7] matched settlement instructions (on the ISINs and transactions in scope of the penalty) which are unsettled at the end of the relevant cut-off on ISD must be subject to a penalty, regardless of their actual technical status: lack of securities, lack of cash, but also instructions put on hold (any type of hold or blocking resulting in the instruction being ineligible for settlement, even if done by the CSD), instructions which do not settle due to a link with another instruction etc…[8] The main driver for this approach is to have a lean penalty system that fosters settlement discipline, i.e. with no exemptions 'by default'. For exceptional cases where settlement cannot be performed for reasons that are independent from any of the participants or the CSD, a penalty management function will be available to reduce the amount of penalty to zero[9].

[7] Live settlement instructions are those which have been positively validated by T2S and are not either bilaterally cancelled, cancelled by the system (due to revalidation of business rules), or settled.

[8] The details of the penalty computation logic are being gathered into a specific document drafted by the CSDR TF. Once finalised, it will be shared with ESMA/EU Commission.

[9] As stated in the Technical Advice under CSDR: "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".

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
				instructions that have been put on hold by a participant.	In line with the general approach and in order to further illustrate the current working assumptions and questions in the CSDR TF, the following scenarios are considered: A. DVP transactions In the scenario of a DVP where there is a calculated lack of securities for the delivery side of the transaction, the view of the CSDR TF is that there should not be any further check on the cash side of the transaction for the counterparty. Flagging the counterparty instruction as failing for lack of cash would not be accurate in this case: (i) First, as cash is a much more liquid/fungible asset than securities, a single provision check on the cash side, at the time when the provision check is failing on the securities side is not deemed meaningful: cash balances may vary constantly during the day, and the buying party would potentially have been able to settle its obligation at some point in time in the day thanks to the settlement of other (sale) transactions if there was no lack of securities of its counterpart. (ii) Furthermore, in case of insufficient cash resources, optimisation mechanisms such as auto-

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					collateralisation could potentially have resolved the lack of cash. Note that the above logic is commonly designed in securities settlement systems[10], a check on cash resources would waste processing time and would not contribute to the settlement efficiency because the transaction cannot settle in the first place. For the above reasons, and with the understanding that the primary driver for the settlement discipline regime is to remedy failing securities transactions, the CSDR TF is of the view that the delivering securities leg should be checked in priority in the provision checking process in a DVP transaction and that, in case of lack of securities, the counterparty instruction should not be checked for cash provision or give rise to a penalty. Obviously, if the provision checking process is successful for the securities leg, a cash penalty shall be due by its counterparty if its settlement instruction is lack of cash. <u>B. FOP transactions</u>

[10] T2S behaviour will be adapted with CR621.

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					Considering that only one of the parties is subject to a delivery obligation, the point requiring clarification is here how to treat the counterparty in case it causes the settlement fail, e.g. it sends its leg of the transaction after ISD or puts in on hold. The majority view in the TF is that, even if the receiving party has no settlement obligation, it should be penalised for causing the settlement fail. The majority view in the CSDR TF is to calculate the penalty in this case as if it was the deliverer, i.e. directly proportional to the quantity and price of the securities. This particular scenario does not seem to be covered in the Technical Advice. C. DWP transactions In the specific case of a Delivery With Payment (DWP) transaction[11] where the party is delivering securities and cash, its counterparty would be suffering from the non-delivery of both securities and cash in case of settlement fail. As a result, the current view in the CSDR TF is to calculate a penalty taking into account both the securities and cash components if the deliverer is the cause of the settlement fail. The

[11] DWP are the result of CCP so-called 'strange nets' or Corporate Action proceeds

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					above would ensure the 'immunisation principle', as referred to in the RTS on Settlement Discipline, for participants which are not at the end of the chain. The same clarification is required as for FOP transactions in case the receiver of a DWP is causing the settlement fail. The view of the CSDR TF is that the same approach shall be taken as for the receiver of a FOP instruction, i.e. penalise the receiver taking into account both the securities and cash components.

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
17	**Formula used for calculation of cash penalties**	Article 7(2) Measures to address settlement fails	Delegated Acts of EU Commission C(2016) 7154 of 11/11/2016 parameters for calculation of cash penalties on settlement Article 3 Reference price of the transaction ESMA/2015/1219 Technical Advice under CSDR	Article 3 Reference price of the transaction 1. The reference price referred to in Article 2 shall be equal to the aggregated market value of the financial instruments determined in accordance with Article 7 for each business day that the transaction fails to be settled. 2. **The reference price** referred to in paragraph 1 **shall be used to calculate the level of cash penalties for all settlement fails, irrespective of whether the settlement fail is due to a lack of securities or cash**.	The Delegated Acts clarify that the reference price of the ISIN shall be used for the calculation of a cash penalty, even in the case where the settlement fail is due to a lack of cash. Therefore, the working assumption in the CSDR TF is to use the reference price with the below formula for all T2S instruction types, DVP/RVP, DFOP/RFOP, DWP/RWP, **except** for Payment Free of Delivery (PFOD) instructions where the ISIN quantity is 0 and which would always result in a null penalty (See proposed adaptation for PFOD, and further details for DWP/RWP, which consist of a securities and a cash component, on the last paragraphs): *Rate* Reference Price* Quantity* where Rate is either: (i) the securities rate of the respective asset class or; (ii) the cash discount rate of the respective currency, as described in the Technical Advice. As regards to when to apply the securities rate vs the cash discount rate, the CSDR TF identified 2 possible approaches:

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					1. Preferred approach by a majority of TF members: only apply the cash discount rate in case the fail reason is “lack of cash”. In this case, the penalty for a RVP which is unsettled for another reason than lack of cash, e.g. because it is on hold, would be computed with the securities rate of the respective asset class. In case the fail reason is “lack of cash”, the penalty for a RVP which is unsettled would be computed with the cash discount rate of the respective currency 2. Alternative approach: apply the cash discount rate in all cases where the settlement instructions failing are delivering cash (e.g. RVP, DWP). In this case, the penalty for a RVP which is unsettled would be computed with the cash discount rate of the respective currency, independently of the fail reason of the instruction. The CSDR TF’s preferred approach is similar in the case of penalties that apply to settlement instructions that have been sent too late for settlement on ISD:

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					Rate Reference Price* Quantity* with the rate **always being** the securities rate of the respective asset class, since no fail reason (including "lack of cash") can be attributed for the late sending. The alternative approach would be to derive the rate to use based on the instruction type, i.e. apply the cash discount rate in all cases where the settlement instruction failing was to deliver cash. However a key problem has been identified should this approach be followed: in the case of penalties to be applied to already matched instructions, T2S would not know who of the deliverer or receiver sent its instruction late (to e.g. the CCP) and would as a result not be able to derive whether to use the securities or cash discount rate. For PFOD instructions, which are mainly used in the context of Corporate Actions payments on stock and flows[12], the CSDR TF's proposal is to adapt the formula and use the cash amount in order not to compute a null penalty. Indeed, while the CSDR TF is of the opinion that CA on stock should not be eligible

[12] As described under Item 11, the CSDR TF's working assumption is that CA on stock should be out of scope of penalties.

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					for penalties, CA on flows are the result of transactions between participants, and should therefore fall within the scope of application of penalties. Furthermore, in some cases, PFOD are also transactions generated by CCPs as a result of netting, i.e. so called "strange nets. With this proposed adaptation, the formula becomes: *Rate*Amount* where Rate would always the cash discount rate of the respective currency and Amount is the cash amount contained in the settlement instruction. Regarding DWP/RWP, the view of the CSDR TF is to calculate a penalty taking into account both the securities and cash components (see Item 16). To do so, the CSDR TF identified 2 alternatives: 1. Preferred approach: use a formula that would take into account both the securities and cash components in a fair way, i.e.: (Rate* Reference Price* Quantity) + (Rate* Amount), where Rate is either: (i) the securities rate of the respective asset class or; (ii) the cash discount rate of the respective currency, as described in the Technical Advice and derived using one of the methods above (either based

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					on status or instruction type). Using the cash amount instead of the reference price of the securities for the cash component of a DWP would ensure a more accurate calculation of the penalty taking into account the market value of the transaction, e.g. if the amount of cash to be delivered is substantially different from the value of the securities to be transferred. 2. Alternative approach: use the standard formula as mentioned by Article 3, i.e. Rate* Reference Price* Quantity and to multiply the result in this case per 2 (one for the security and one for the cash component). However, it would result in a penalty calculated solely on the basis of the securities to be delivered and not taking into account the cash value of the transaction for which the counterparty would also suffer the non-delivery. The Rate in this formula would be derived similarly to the preferred approach, either: (i) the securities rate of the respective asset class or; (ii) the cash discount rate of the respective currency.

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
18	**Usage of communication procedures and standards with participants and market infrastructures**	Article 35 Communication procedures with participants and other market infrastructures	CSDR Q&A: CSD Question 4 [last update 13 March 2017] Conduct of business rules - Article 35 of CSDR Does Article 35 of CSDR allow CSDs to use internal or proprietary messaging standards in their communication procedures with participants of the securities settlement system?	**CSDR Q&A** **CSD Question 4**: Does Article 35 of CSDR allow CSDs to use internal or proprietary messaging standards in their communication procedures with participants of the securities settlement system? **CSD Answer 4:** Article 35 of CSDR expressly requires that CSDs use "international open communication procedures and standards with participants and market infrastructures" and allows for no flexibility, therefore internal or domestic messaging standards would not fulfil this requirement, even with a mapping from domestic standards to international open communication procedures	ESMA states in its CSDR Q&A that domestic/proprietary messaging standards would not fulfil the requirement of Article 35 of the CSDR, even with a mapping from domestic standards to international open communication procedures and standards such as the SWIFT/ISO standards. While T2S uses ISO20022 standards in its communication with CSDs and will develop messages for the reporting of cash penalties based on this standard, the communication between CSDs and their clients is still broadly based on the ISO15022 messaging standards. May ESMA confirm that CSDs: (i) are allowed to use ISO15022 messaging for communication with their clients and; (ii) should agree on a single standard/set of ISO15022 messages for the reporting of cash penalties (in which case also comes the question of the international body who would create such standard)? **Update 16/05/2017:** Some CSDR TF members highlighted that this requirement may not be in line with PFMI Principle 22 explanatory note, inter alia 3.22.1 stating "An FMI is

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ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
				and standards such as the SWIFT/ISO standards.	encouraged but not required to use or accommodate internationally accepted communication procedures and standards for purely domestic transactions."

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
19	**Calculation of aggregated amounts for collection and redistribution of penalties**	Article 7(2) Measures to address settlement fails	ESMA RTS Settlement discipline: Article 16 – Collection of cash penalties Article 17 – Redistribution of cash penalties ESMA RTS Settlement discipline Preamble point 20, point 22	ESMA RTS Settlement discipline: Article 16 – Collection of cash penalties "A CSD shall charge and collect at least monthly the net amount of cash penalties to be paid by each participant." […] A CSD shall receive the collected cash penalties into a dedicated cash account." Article 17 – Redistribution of cash penalties The CSD shall redistribute to the receiving participants that suffered from a settlement fail the net amount of cash penalties that it has collected in accordance with Article 16, at least monthly. ESMA RTS Settlement discipline	The RTS on Settlement Discipline states that CSDs s**hould charge and collect at least monthly** the **net amounts** of penalties to be paid by each participant, receive the collected penalties into a dedicated cash account, and **redistribute** those penalties, without **facing credit risks** that stem from the failure of participants to pay the cash penalty due. However, it also states that "for practical reasons and in order to limit the number of cash transfers, CSDs should net the amount due to a participant against the amount to be paid by that same participant". While the regulation is clear on the fact that CSDs can only distribute cash penalties that they have collected and should maintain their risk free profile, the CSDR TF has identified **several options for CSDs to collect and re-distribute those "net amounts**". It has been stressed that the scope of the exemption provided to CSD participants in case of insolvency (Item 12 of this list) would have an impact on the process of collection and redistribution of penalties, both from a technical and operational standpoint,

ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
				Preamble point 20: "The risk profile of a CSD should not be altered due to its operation of the penalty mechanism. A CSD should therefore not face credit risks that stem from the failure of participants to pay the cash penalty due." ESMA RTS Settlement discipline Preamble point 22: "For practical reasons and in order to limit the number of cash transfers, CSDs should net the amount due to a participant against the amount to be paid by that same participant. "	hence these 2 items should not be looked at independently. Looking at the implications of a non-paying participant, the requirements of the CSDR to maintain the risk-free profile of the CSD, and the operational and technical aspects of the collection and re-distribution process of cash penalties, the CSDR TF has identified a preferred option (even though none of the options reached full consensus): **Preferred option by the CSDR TF:** Option 3B: Calculation of a net bilateral amount per CSD participant and counterpart, without further aggregation for the payment. In this option, the net amounts are calculated on a bilateral basis between 2 counterparts, so as to have one exposure per counterparty. All the exposures towards individual counterparts where the CSD participant has to pay are collected via separate payments by the CSD, while all the exposures where the CSD participant is entitled to receive are re-distributed separately in a second step. The key advantage from this option compared to all others is

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ID	CSDR Item	Level 1 Article reference	Level 2 Article reference	Quote of relevant text	Point requiring clarification
					that it would not require any recalculation in case of non-payment of a CSD participant, an aspect deemed particularly important in a cross-CSD context where a CSD is also acting as a participant of another CSD: non-payments could, otherwise, affect or even block the collection and distribution process of several CSDs. Similarly, the segregation of penalties per counterparty may prove very helpful in the case of CCPs. Although the penalties for or against a CCP must be informed, the CSD must not charge the CSD participant if it's counterparty is the CCP or vice versa (cf. article 18 of RTS on Settlement Discipline). Consequently, if this segregation is not provided, the CSD would have to perform it anyway to exclude these penalties from the payments. On the downside, the reconciliation effort is deemed higher due to the higher number of payments to be performed by each CSD participant. **Alternative options discussed in the CSDR TF:** Option 3A: Calculation of a net bilateral amount per CSD participant and counterpart, then an aggregated amount due and aggregated amount to be received per CSD participant.

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					This option is a variant from the one previously described: similarly, the net amounts are calculated on a bilateral basis between 2 counterparts, so as to have one exposure per counterparty. Where it differs is that all exposures towards individual counterparts where the CSD participant has to pay are summed and collected into a single payment by the CSD, while all the exposures where the CSD participant is entitled to receive a penalty are aggregated and re-distributed via a single payment in a second step. This variant addresses the issue of a high number of payment described in the preferred option, while keeping track of bilateral exposures between counterparties. However, some TF members feel that this variant strongly reduces the benefits listed in option 3B, as it will require a re-calculation of the total amount in case of non-payment of a participant. Option 1: Calculation of an aggregated amount due and aggregated amount to be received per CSD participant. In this option, all penalties to be paid by each CSD participant are aggregated into a single amount, and collected by the CSD. In a second step, all penalties

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					to be received by each CSD participant are paid by the CSD. The main benefit of this option is its simplicity for the calculation of the amounts to be paid by participants (sum of all penalties to be paid, and sum of all penalties to be received). Furthermore, the collection / redistribution sequence is fully respected without any netting performed by the CSD. The drawbacks from this approach would be the higher liquidity requirements, as the amounts that the CSD participant has to pay are not netted against those that it is entitled to receive. However, it was mentioned that this should not in practice be an issue, as the amounts of cash penalties to be paid are not expected to be very high. Furthermore, this could create a further incentive for settlement discipline. In case of a non-paying participant, this option would require a re-calculation of the amounts to be paid, with a complexity level that would increase in cross-CSD scenarios. As regards whether this option could possibly be interpreted as not being fully in line with the preamble 22 of the RTS on Settlement Discipline, it was mentioned that the text did not seem very

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					prescriptive and recommended a netting of amounts "for practical reasons". Option 2: Calculation of a single net amount per CSD participant In order to calculate this net amount, an aggregation of the penalties due and to be received is done across all counterparties, and a single payment is to be done between the CSD participant and the CSD. The CSD collects from the CSD participants that are net debitors in a first step, then the CSD re-distributes to those CSD participants that are net creditors in a second step, in order to maintain the risk free profile of the CSD. Advantages of this approach would be to minimise liquidity requirements towards CSD participants, as well as simplify the reconciliation process. However, a main drawback has been identified, in case of a non-paying participant, since this would require a full unwinding and recalculation of penalties to be performed, which would potentially impact all CSD participants (and not only the counterparties of the non-payer), and also delay the whole set of payments to be made, which according to some members shall be done in the same day. This

Deleted: Alternative options identified but not favoured by the CSDR TF:¶

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					has been deemed as a particular concern in cross-CSD scenarios. Some TF members therefore view this option as very difficult to manage from a CSD standpoint, mentioning that the CSD could be holding cash for an extended period and that there could be a risk for reversal of payments. Hence, this option was the least favoured by the CSDR TF.

Deleted: Option 3A: Calculation of a net bilateral amount per CSD participant and counterpart, then an aggregated amount due and aggregated amount to be received per CSD participant.¶
In this option, the net amounts are calculated on a bilateral basis between 2 counterparts, so as to have one exposure per counterparty. All exposures towards individual counterparts where the CSD participant has to pay are summed and collected into a single payment by the CSD, while all the exposures where the CSD participant is entitled to receive a penalty are aggregated and re-distributed via a single payment in a second step. The benefits of this option are the reduced complexity for recalculation in case of non-payment of a participant with a view of the exposure per counterparty, along with lower liquidity requirements compared to option 2. However, it was mentioned that the initial calculation algorithm was more complex to implement.¶
Option 3B: Calculation of a net bilateral amount per CSD participant and counterpart, without further aggregation for the payment.¶
This option is similar to the one above, except that the bilateral exposures per counterparty are not summed to have one single amount to be paid or to be re-distributed by CSD participant. In this option, exposures towards individual counterparts where the CSD participant has to pay are collected via separate payments by the CSD, while all the exposures where the CSD participant is entitled to receive are re-distributed separately in a second step. The key advantage from this option compared to all others is that it would not require any recalculation in case of non-payment of a CSD participant. The main drawback would be that this would result in a higher number of payments (one per counterpart).