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Final Report

Technical Advice on the Scope of CSDR Settlement Discipline

Table of Contents

Legislative References

CSDR[1]	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
CSDR Refit[2]	Regulation (EU) No 2023/2845 of the European Parliament and of the Council of 13 December 2023 amending Regulation (EU) No 909/2014 as regards settlement discipline, cross-border provision of services, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories and amending Regulation (EU) No 236/2012
MiFID II[3]	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast)
MiFIR	Regulation (Eu) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012
RTS on CSD Requirements	Commission Delegated Regulation (EU) 2017/392 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on authorisation, supervisory and operational requirements for central securities depositories
RTS on Settlement Discipline[4]	Commission Delegated Regulation (EU) 2018/1229 of 25 May 2018 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline

[1] OJ L 257, 28.8.2014, p. 1
[2] OJ L, 2023/2845, 27.12.2023
[3] OJ L 173, 12.6.2014, p. 349
[4] OJ l 230, 13.9.2018, p.1

List of acronyms

CP	Consultation Paper
CSD	Central Securities Depository
ESMA	European Securities and Markets Authority
EC	European Commission
ECB	European Central Bank
ETF	Exchange traded fund
EU	European Union
FoP	Free of Payment
ISIN	International Securities Identification Number
MBI	Mandatory buy-in
RTS	Regulatory Technical Standards
STP	Straight-through processing
T2S	TARGET2-Securities

1 Executive Summary

Reasons for publication

One of the changes brought by CSDR Refit[5] refers to the need for further specification of the scope of the settlement discipline rules to make them more operational and better tailored to the diversity of market operations and transactions that can potentially be subject to the regime.

As such, Article 7(9) of CSDR[6], as amended by CSDR Refit, empowers the European Commission (EC) to adopt delegated acts to supplement the CSDR by specifying: i) the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction, and ii) the circumstances in which operations are not considered as trading.

In light of the above, ESMA has received a request to provide technical advice to assist the EC in preparing such a delegated act.

ESMA published a Consultation Paper (CP) on 9 July 2024 to collect views, comments, and opinions, as well as data and evidence from stakeholders and market participants on ESMA's preliminary proposals on the two topics mentioned above.

Contents

ESMA's technical advice includes proposals on clarifying the scope of settlement discipline, aiming at streamlining the regulatory framework and alleviating unnecessary burdens on market participants, in line with the simplification and burden reduction objectives of the CSDR Refit.

This Final Report covers the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction, and the circumstances in which operations are not considered as trading, and which should not be subject to settlement discipline measures.

Regarding settlement fails that are considered as not attributable to the participants, ESMA expands on the scenarios initially identified in the CSDR Q&As[7] to include: ISIN suspensions due to reconciliation issues; technical failures at the CSD level, such as system outages, cyberattacks, or network issues; full-day trading suspension of an ISIN on its most liquid market; cash settlement issues when the relevant payment system is closed; instructions involving sanctioned securities or issuers; instructions blocked by official orders from authorities; CSD risk management procedures foreseen in an exceptional manner; and technical errors or data issues at the CSD not caused by participants.

ESMA has identified the following operations which should not be considered as trading: (de)mobilisation of collateral for ESCB credit operations; market claims and corporate actions on stock; technical creation of securities; share registration; technical creation and redemption of fund units or shares on the primary market (including ETFs shares), i.e. the crediting (in the case of creation) or the debiting/elimination (in the case of redemption) of the fund units or shares from the fund/transfer agent CSD account; technical realignment operations between CSDs including T2S technical realignment operations.

ESMA recommends handling exemptions for settlement fails not caused by participants through ex-post claims, unless a CSD's cost-benefit analysis shows that ex-ante filters would be more efficient. In contrast, for exemptions related to non-trading operations, ESMA advises CSDs to apply ex-ante filters due to the high volume of cases involved.

Accordingly, ESMA proposes different application dates for each exemption. The exemption for settlement fails not attributable to participants should follow the standard timeline. However, for operations not considered as trading, ESMA recommends a longer implementation period, at least 12 months after the Commission Delegated Act is published in the Official Journal of the EU, and ideally no later than the end of Q2 2027.

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[5] Regulation (EU) 2023/2845 of the European Parliament and of the Council of 13 December 2023 amending Regulation (EU) No 909/2014 as regards settlement discipline, cross-border provision of services, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories and amending Regulation (EU) No 236/2012; OJ L, 2023/2845, 27.12.2023, ELI: http://data.europa.eu/eli/reg/2023/2845/oj.
[6] 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; OJ L 257, 28.8.2014, p. 1–72; https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02014R0909-20250117.
[7] ESMA70-156-4448 CSDR Q&As (europa.eu)

Finally, ESMA addresses the eventual alignment between the scope of cash penalties and the mandatory buy-in (MBI).

Each section contains ESMA's assessment, together with ESMA's technical advice to the EC. The Final Report also includes the impact assessment regarding the proposed measures, as well as the Securities and Markets Stakeholder Group (SMSG) advice. A detailed summary of the feedback received can be found in Annex I.

Next Steps

The EC will consider ESMA's technical advice when preparing a new delegated act supplementing CSDR further specifying the scope of operations and transactions subject to the settlement discipline regime. The EC powers to adopt delegated acts are subject to Article 67 of CSDR that allows the European Parliament and the Council to object to a delegated act within a period of 3 months, extendible by 3 further months at the initiative of the European Parliament or of the Council.

2 Introduction

1. CSDR entered into force on 17 September 2014. CSDR includes a set of measures to prevent and address failures in the settlement of securities transactions (settlement fails), commonly referred to as settlement discipline measures. These measures consist of reporting requirements, cash penalties for central securities depositories' (CSD) participants in case of settlement fails, and mandatory buy-ins where a CSD participant fails to deliver the security within a fixed extension period.

2. CSDR has been recently reviewed, with the objective of ensuring that the Regulation remains proportionate, effective, and efficient. CSDR Refit entered into force on 17 January 2024.

3. One of the changes brought by CSDR Refit refers to the refinement of the scope of the settlement discipline rules. Making the settlement discipline regime more operational requires not automatically penalising every individual settlement fail regardless of the context, or the parties involved.

4. Article 7(3) (Measures to address settlement fails) of CSDR, as amended by CSDR Refit, specifies that settlement fails the underlying cause of which is not attributable to the participants in the transactions or operations that are not considered as trading are not subject to the penalty mechanism (Article 7(3), points (a) and (b)).[8]

5. In addition, Article 7a(7), point (a) (Mandatory buy-in process), as introduced by the CSDR Refit, exempts the settlement fails stemming from operations and transactions listed in Article 7(3) from the mandatory buy-in process.

6. Lastly, Article 7(9) of CSDR, as amended by CSDR Refit, empowers the EC to adopt delegated acts in accordance with Article 67 to supplement the CSDR by specifying the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction under Article 7(3), point (a), and the circumstances in which operations are not considered as trading under Article 7(3), point (b).

7. ESMA has received a request from the EC to provide technical advice to assist in preparing such a delegated act. This request sets out the principles which ESMA is invited to consider when developing its advice, including proportionality and coherence within the regulatory framework of the Union. ESMA is invited to widely consult market participants in an open and transparent manner and to consider the resulting opinions

[8] Recital (7) of CSDR Refit explains that the scope of cash penalties should be clarified in light of the evidence gathered since the entry into application of CSDR. Additionally, recital (8) of the same Regulation clarifies that settlement fails the underlying cause of which is not attributable to the participants and operations that are not considered as trading should not be subject to cash penalties or mandatory buy-ins, since the application of those measures to such settlement fails and operations would not be practicable or could lead to detrimental consequences for the market.

in its advice. ESMA is also invited to justify its advice by providing a quantitative and qualitative cost-benefit analysis of all the options considered and proposed.

8. Accordingly, this technical advice covers the underlying causes of settlement fails not considered as attributable to the participants in the transactions, the circumstances in which operations are not considered as trading and the practical implementation of those exemptions. To that end, it describes and analyses the feedback received by ESMA following the related public consultation. Finally, this technical advice carries out a cost-benefit analysis of the main policy options adopted.

3 Underlying causes of settlement fails that are considered as not attributable to the participants in the transactions

3.1 Background

9. In the CP, ESMA proposed a list of situations where settlement cannot be performed for reasons that are independent from the involved participants, which had been included in pre-existing ESMA Q&As[9]:

   a. ISIN suspension from settlement due to a reconciliation issue under Article 65 (2) and (6) of the RTS on CSD Requirements[10];

   b. ISIN suspension from trading, such as for example under Article 32(1), Article 52(1), Article 69(2) of MiFID II or Article 40(1) of MiFIR;

   c. settlement instructions involving cash settlement outside the securities settlement system operated by the CSD if, on the respective day, the relevant payment system is closed for settlement;

   d. technical impossibilities at the CSD level that prevent settlement, such as: a failure of the infrastructure components, a cyber-attack, network problems, technical (IT) issues in the system of the CSD.

10. ESMA also proposed additional scenarios that may be considered where settlement cannot be performed or has to be postponed for reasons that are independent from the involved participants, such as:

   a. settlement instructions involving securities under sanctions or anti-money laundering proceedings; and

[9] ESMA70-156-4448 CSDR Q&As (europa.eu)
[10] Commission Delegated Regulation (EU) 2017/392 on authorisation, supervisory and operational requirements for central securities depositories; *OJ L 65, 10.3.2017, p. 48–115; https://eur-lex.europa.eu/eli/reg_del/2017/392/oj/eng*.

b. settlement instructions put on hold due to the order issued by a court, the police or similar authority with relevant mandate.

3.2 Feedback to the consultation

11. As regards the scenarios proposed in the CP, ESMA notes the widespread support and the non-controversial nature of some of the proposed exemptions. In particular, the scenarios regarding ISIN suspension from settlement due to a reconciliation issue and technical impossibility at the CSD level that prevent settlement did not receive any comments. The other scenarios received more technical comments.

12. ESMA notes the wide support received by the proposal regarding settlement instructions involving cash settlement if on the respective day the relevant payment system [11] is closed for settlement from most respondents, including the CSD community. According to one response, CSDs can only apply this exception when the payment system is known to them. ESMA acknowledges that this would be necessary for the CSD to pre-filter the exemption, but not to apply it ex-post following claims made by participants during the appeal process related to the penalty mechanism.

13. Regarding the scenario based on **ISIN suspension from trading**, there were two main sets of comments provided by CP respondents:

    a. Some stakeholders considered that trading suspension of a financial instrument (ISIN) does not imply the suspension of settlement in the same financial instrument since it can be traded on more than one trading venue or OTC;

    b. The second argument is not related to the scenario as such but to its practical implementation, since many respondents noted that the CSDs' source of information is FIRDS which does not provide information about trading suspensions. This element will be further analysed in the section regarding the practical implementation of these exemptions.

14. Respondents also suggested a number of cases where settlement fails could arise as a consequence of the CSDs' operational processes (e.g. CSDs rejecting instructions on an ISIN when it lacks or has not recorded yet the necessary master data; deletion of instructions by the CSD due to errors not attributable to the instructing party; settlement instruction de-selection by a CSD with an interoperable link with another CSD).

[11] For clarity, ESMA uses the term 'payment system' as defined in Article 4(1)(7) of Directive (EU) 2015/2366: a funds transfer system with formal and standardised arrangements and common rules for the processing, clearing and/or settlement of payment transactions. See as well the ECB Regulation on oversight requirements for systemically important payment systems: *a formal arrangement between three or more participants, not counting possible settlement banks, central counterparties, clearing houses or indirect participants, with common rules and standardised arrangements for the execution of transfer orders between the participants*.

3.3 ESMA's assessment and final approach

15. As regards settlement instructions involving cash settlement if on the respective day the relevant payment system[12] is closed for settlement, ESMA remains of the view that they should be left out of the scope of settlement discipline.

16. In relation to the comment noting that CSDs can only apply this exception when the payment system is known to them, ESMA acknowledges that this would be necessary for the CSD to pre-filter the exemption. However, it would not be necessary to apply it ex-post following claims made by participants during the appeal process related to the penalty mechanism. ESMA also understands that taking into account the opening and closing times of external payment systems not used by CSDs or, in the case of settlement in T2S, not T2, would be operationally very complex. However, as mentioned before, ESMA considers that this exemption can be managed ex-post through the appeal process.

17. ESMA concludes that this scenario should be maintained in line with the existing Q&A: "settlement instructions involving cash settlement outside the securities settlement system operated by the CSD if, on the respective day, the relevant payment system is closed for settlement".

18. As regards the comments received in relation to the ISIN suspension from trading, ESMA does not consider that those points should imply that the scenario as a whole should be disregarded. There are several reasons supporting this approach.

19. Firstly, it is essential to analyse under which circumstances a trading suspension would lead to a situation where settlement cannot be performed for reasons that are independent from the participants involved. A trading suspension often signals significant issues with the security or the issuer, disrupting normal price discovery and liquidity mechanisms.

20. As a result, acquiring financial instruments for settlement may become practically impossible. ESMA has analysed three different possible scenarios:

    a. where the financial instrument is traded on only one trading venue;

    b. when the financial instrument is traded on several trading venues, and it is suspended on all of them; and

[12] For clarity, ESMA uses the term 'payment system' as defined in Article 4(1)(7) of Directive (EU) 2015/2366: a funds transfer system with formal and standardised arrangements and common rules for the processing, clearing and/or settlement of payment transactions. See as well the ECB Regulation on oversight requirements for systemically important payment systems: *a formal arrangement between three or more participants, not counting possible settlement banks, central counterparties, clearing houses or indirect participants, with common rules and standardised arrangements for the execution of transfer orders between the participants*.

c. when the financial instrument is admitted to trading or traded on several venues and is suspended on the most relevant market in terms of liquidity[13].

21. ESMA considers that settlement fails caused by the participant's inability to acquire a financial instrument due to the suspension of trading of that financial instrument (ISIN) in the most relevant market in terms of liquidity for at least one entire trading session should not be considered as attributable to the participants. When the most relevant market in terms of liquidity suspends trading, the continuous trading process is no longer possible. It is important to note that the MiFID II framework considers the interdependencies between the multiple trading venues where a financial instrument is traded[14] and the financial instruments related to it, envisaging:

a. The compulsory suspension of derivatives referred to in points (4) to (10) of Section C of Annex I that relate or are referenced to that financial instrument where necessary to support the objectives of the suspension or removal of the underlying financial instrument;

b. The other trading venues that trade the same financial instrument in that jurisdiction suspend trading in those financial instruments where the suspension or removal is due to suspected market abuse, a take-over bid or the non-disclosure of inside information;

c. The NCAs from other jurisdictions require the trading venues where the same financial instrument(s) is/are traded to suspend as well where the suspension or removal is due to suspected market abuse, a take-over bid or the non-disclosure of inside information.

22. Even if secondary trading venues do not suspend trading, they may lack the same level of liquidity. This could hinder the ability to build large positions if trading is suspended for an entire day in the most relevant market in terms of liquidity.

23. ESMA has also evaluated the operational benefits of this model. Further details are provided in the section on the practical implementation of the exemptions.

24. ESMA also notes that most trading suspensions only last a few hours. In such cases, it would not be justified to benefit from the exemption, as participants could buy the securities once trading resumes. Therefore, the exemption should apply when the trading suspension covers an entire trading day, and it should be valid for the respective day(s) only.

25. ESMA also considered a scenario where a trading suspension occurs during the trading session and lasts until the end of the trading day. However, ESMA understands

[13] Article 4(1)(a) of MiFIR and Article 4 of Commission Delegated Regulation (EU) 2017/587.
[14] Articles 32 and 52 of MiFID II.

that the main risk lies in the build-up of positions in the context of short selling practices, where short sellers must deliver previously borrowed securities. Given that Articles 12 and 13 of the Short Selling Regulation prohibit uncovered short sales of shares and sovereign debt and require short sellers to ensure that shares are available for settlement, ESMA believes that market participants involved in short selling practices should have addressed this risk before entering into a short position.

26. ESMA wants to clarify that the references to “trading suspensions” include suspensions declared by the investment firm or market operator operating an MTF, OTF or regulated market under Articles 32 and 52 of MiFID II and regulatory suspensions demanded by national competent authorities under Article 69(2) of MiFID II or by ESMA under Article 40(1) of MiFIR. On the contrary, temporary trading halts and circuit breakers under Article 48(5) of MiFID II should not trigger an exemption from settlement discipline.

27. Moving on to the next case, ESMA considers it adequate to revise the wording of the exception regarding “**settlement instructions involving securities or issuers under sanctions or anti-money laundering proceedings**”, in line with the feedback received. Since the exemption is focused on the securities or the issuer, all the parties involved in a chain of transactions can equally benefit from the exemption, ensuring that the immunisation principle is maintained to the extent possible.

28. Conversely, ESMA does not believe that the exemption should be amended to reflect sanctions imposed on individuals (CSD participants, intermediaries, and trading parties who are direct or indirect clients of CSD participants). The main issues with this suggestion come from the following facts:

    a. As opposed to the case of insolvency in Article 7(3)(d) of CSDR, it is unclear which type of sanctions would trigger the exemption;

    b. ESMA agrees with the complexities that such exemption would entail: CSDs would not be able to identify such fail reasons, increasing the administrative burden for them and participants;

29. Regarding the scenario covering settlement instructions put on hold due to an order issued by a court, the police or similar authority with a relevant mandate, ESMA recognizes that settlement instructions can be put on hold further to the request of a larger number of authorities than the ones initially included in its proposal. Accordingly, it has amended the proposed exemption to reflect that the originator can be “a government institution, court, regulatory authority, or other similar authority with a relevant mandate” as suggested by one respondent.

30. As regards additional proposals regarding potential causes of settlement fails that are not attributable to the participants in the transactions, some stakeholders put forward examples already addressed through the proposed exemptions linked to cases not considered as trading. Therefore, these cases are analysed in the related section.

31. ESMA notes the suggestion to add a generic exemption identifying "all situations where a CSD suspends settlement". ESMA believes that CSDs should only be allowed to suspend settlement in specific circumstances that are duly justified, such as technical impossibilities at CSD level that prevent settlement.

32. ESMA considers necessary to address the proposals received in relation to several cases where settlement fails could arise as a consequence of the CSDs' operational processes.

33. In the case of the Bridge between the two ICSDs, ESMA understands that, in very rare circumstances, despite the fact that the buyer has sufficient cash or secured credit, the delivery of the securities could create an exposure in the delivering ICSD that might exceed the credit exposure covered by equivalent financial resources described in Article 16 of Commission Delegated Regulation (EU) 2017/390 on certain prudential requirements for central securities depositories and designated credit institutions offering banking-type ancillary services [15]. ESMA notes that risk management procedures are required by Article 48 of CSDR. At the same time, ESMA would like to highlight that NCAs should ensure that the risk management procedures like the one for the Bridge mentioned above should not generate settlement fails on a normal basis,

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[15] *Article 16*

Other equivalent financial resources for exposures in interoperable links

Other equivalent financial resources may include bank guarantees and letters of credit, used to secure credit exposures created between CSDs that establish interoperable links, that meet all of the following conditions:

(a) they cover only the credit exposures between the two linked CSDs;

(b) they have been issued by a consortium of creditworthy financial institutions that fulfil the requirements set out in Article 38(1), in which each of those financial institutions is obliged to pay the part of the total amount that has been contractually agreed upon;

(c) they are denominated in a currency the risk of which the CSD-banking service provider is able to adequately manage;

(d) they are irrevocable, unconditional and the issuing institutions cannot rely on any legal or contractual exemption or option allowing the issuer to oppose the payment of the letter of credit;

(e) they can be honoured, on demand, free of any regulatory, legal or operational constraint;

(f) they are not issued by:

(i) an entity that is part of the same group as the borrowing CSD or a CSD with an exposure covered by the bank guarantee and letters of credit;

(ii) an entity whose business involves providing services critical to the functioning of the CSD-banking service provider;

(g) they are not subject to significant wrong-way risk within the meaning of Article 291 of Regulation (EU) No 575/2013;

(h) the CSD-banking service provider monitors the creditworthiness of the issuing financial institutions on an regular basis by independently assessing the creditworthiness of those institutions and by assigning and regularly reviewing internal credit ratings for each financial institution;

(i) they can be honoured during the period of liquidation within three business days from the moment when the defaulting CSD-banking service provider fails to meet its payment obligations when they are due;

(j) qualifying liquid resources referred to in Article 34 are available to a sufficient amount that covers the time gap until the time at which the bank guarantee and letters of credit has to be honoured in case of default of one of the linked CSDs;

(k) the risk of not having the full amount of the bank guarantee and letters of credit being paid by the consortium is mitigated by:

(i) establishing appropriate concentration limits ensuring that no financial institution, including its parent undertaking and subsidiaries, is part of the consortium guarantees for more than 10 % of the total amount of the letter of credit;

(ii) limiting the credit exposure that is covered using the bank guarantee and letters of credit to the total amount of the bank guarantee minus either 10 % of the total amount, or the amount guaranteed by the two credit institutions with the largest share of the total amount whichever is lower;

(iii) implementing additional risk mitigation measures such as a loss-sharing arrangements that are effective and have clearly defined rules and procedures;

(l) the arrangements are periodically tested and reviewed pursuant to Article 41(3) of Regulation (EU) No 909/2014.

but only in very limited cases and in an exceptional manner, such as for instance if there is a peak in the settlement activity.

34. Therefore, ESMA believes that risk management procedures at the CSD level foreseen in an exceptional manner should also be included in the list of situations where settlement cannot be performed for reasons that are independent from the involved participants.

35. As regards other cases put forward by the respondents to the CP (CSDs rejecting instructions on an ISIN when it lacks or has not recorded yet the necessary master data; deletion of instructions by the CSD due to errors not attributable to the instructing party), ESMA would like to clarify that:

   a. These situations typically do not result in cash penalties. For instance, where the CSD has not recorded the necessary master data, it would reject both settlement instructions and no cash penalty would be generated; and

   b. These situations are the result of technical limitations, mistakes, or malfunctions in the CSDs' systems. In these instances, the lack of settlement is clearly attributable to the CSD, not to the CSD participants[16].

36. In such cases, imposing penalties on participants rather than on CSDs places an undue burden on them and sends the wrong message to the market. ESMA would like to clarify that these cases should not be considered within 'technical impossibility at the CSD level that prevents settlement' (see paragraph 67.b) covering the failure of the infrastructure components, a cyber-attack, network problems or technical (IT) issues in the system of the CSD.

37. Regarding **insolvency proceedings**, ESMA would like to point out the provisions of Article 7(3) point (b) of CSDR, as amended by CSDR Refit, according to which the penalty mechanism shall not apply to transactions where insolvency proceedings are opened against the failing participant. According to Article 7a(7) point (a) of CSDR, as amended by CSDR Refit, such transactions are also exempted from the mandatory buy-in (MBI). Since these cases are already covered by Level 1, ESMA has not covered them in this Technical Advice.

38. Therefore, and in line with the overall objective of simplification and burden reduction, ESMA considers that the following cases should not trigger the application of cash penalties and MBI if they generate settlement fails, given that such settlement fails are not attributable to the participants in the transactions:

[16] Article 7(2) third sub-paragraph of CSDR: The penalty mechanism referred to in the first subparagraph shall include cash penalties *for participants that cause settlement fails ('failing participants')* (emphasis added).

a. ISIN suspension from settlement due to a reconciliation issue under Article 65 (2) and (6) of the RTS on CSD Requirements;

b. Technical impossibilities at the CSD level that prevent settlement, consisting of a failure of the infrastructure components, a cyber-attack, network problems or technical (IT) issues in the system of the CSD;

c. ISIN suspension from trading on the most relevant market in terms of liquidity, if the suspension lasts for the entire trading day;

d. Settlement instructions involving cash settlement if, on the respective day, the relevant payment system is closed for settlement;

e. Settlement instructions involving securities or issuers under sanctions or anti-money laundering proceedings;

f. Settlement instructions put on hold due to an order issued by a government institution, court, regulatory authority, or other similar authority with a relevant mandate;

g. Risk management procedures at the CSD level foreseen in an exceptional manner;

h. Situations derived from technical limitations, mistakes, or malfunctions in the CSDs' systems, including CSDs rejecting instructions on an ISIN due to missing or incorrect master data that is not due to participants' fault, or deletion of instructions by CSDs due to errors not attributable to the instructing participants.

4 Circumstances in which operations are not considered as trading

4.1 Background

39. During the CSDR Review and the targeted consultation supporting the CSDR Review[17], stakeholders identified a number of transactions that should be out of scope of the settlement discipline regime.

40. For instance, the ECB suggested to clarify the scope of transactions that do not involve "two trading parties" arguing that free-of-payment securities transfers to accounts at CSDs in the context of the (de)mobilisation of collateral, irrespective of whether those

[17] "Summary report of the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories, 8 December 2020 – 2 February 2021". Out of the 58 respondents to questions relating to requirements applying to the settlement of financial instruments, 51 replied that clarifications are necessary. These include public authorities, CSDs, their participants, clients of the participants and associations. See p.38 – p.43. Paragraph 1.2, Opinion of the European Central Bank of 28 July 2022 on a proposal for a regulation amending the Central Securities Depositories Regulation, CON/2022/25, Official Journal of the European Union C367/3, 26.09.2022.

transfers are between private parties or between members of the ESCB and their counterparties, should be excluded from the settlement discipline regime.

41. Some stakeholders argued that portfolio transfers where the parties delivering and receiving securities are the same should be exempted. Other market participants believed that primary market trades should be exempt from the MBI as it would be disruptive for those markets.

42. In the CP, ESMA proposed that the following operations should not be considered as trading for the purpose of the application of cash penalties and the MBI:

    a. free-of-payment (FoP) securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral;
    b. market claims, corporate actions on stock, such as cash distributions (e.g. cash dividend, interest payment), securities distributions (e.g. stock dividend; bonus issue), reorganisations (e.g. conversion, stock split, redemption, tender offer);
    c. the process of technical creation of securities, meaning the transfer from the CSD's issuance account to the issuer's CSD account;
    d. creation and redemption of fund units on the primary market, meaning the technical creation and redemption of fund units (except for ETFs);
    e. realignment operations.

43. For the sake of clarity, ESMA indicated in the CP that a failed delivery on a market sale transaction caused by the delay in issuing the instrument on the primary market or restrictions during a corporate action should not be considered as excluded from the application of cash penalties and the MBI.

44. ESMA sought feedback from market participants on which operations, not classified as 'trading', could breach the 'immunisation principle'.

4.2 Feedback to the consultation

45. Most respondents agreed with the proposal regarding **free of Payment (FoP) securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral** despite many respondents considered that the proposal was not sufficiently clear. In particular, some of them requested clarification on whether tri-party collateral agreements would fall under the scope of this exemption and on whether a FoP collateral transfer to settle an ongoing transaction would be exempted. Other responses noted that, without further specification, the exemption might breach the immunisation principle. In general, most of respondents did not agree to generally

exempting the movement of collateral between market participants from the scope of cash penalties.

46. Respondents were generally supportive of the proposal regarding m**arket claims, corporate actions on stock such as cash distributions, securities distributions, reorganisations.** However, some comments considered that this exception could breach the immunisation principle.

47. As regards the process of the **technical creation of securities**, respondents were generally supportive of this exemption. However, a number of replies noted the practical implications of this proposal.

48. Respondents were generally supportive of the exemption regarding the **creation and redemption of fund units on the primary market** (i.e. the technical creation and redemption of fund units). For ETFs in particular, several responses distinguished between the primary market transaction and the technical creation of ETF shares.

49. Respondents agreed that **realignments** within the context of T2S should be specifically left out of scope. It is worth noting that some stakeholders considered this exception as too vague and requested further specification in the final technical advice.

50. As regards potential additional scenarios that should not be considered as trading, the main bulk of these responses considered that the **transfer of securities from one CSD account to another CSD account that does not imply a change of ownership** should be deemed equivalent to T2S realignments.

51. Apart from that, there were requests for exempting **share registration bookings**, which were considered particularly relevant for the German market.

4.3 ESMA's assessment and final approach

52. **Free of Payment (FoP) securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral**.

53. The feedback highlighted the proposal's lack of clarity, raising concerns about the potential impact of a broad exemption scope. Respondents were worried about firms' ability to efficiently manage their risk and the indirect implications for financial stability, particularly in the context of late recalls of securities lending transactions.

54. In particular, the ESMA's SMSG and several other respondents raised the same risk: if FoP collateral transfer transactions are excluded, there could be a fundamental risk that, for example, in cases of late recalling of a securities lending transaction due to a sale, the cash claiming process vis-à-vis the lending counterparty could no longer be carried out. FoP security collateral transfers may sometimes break the immunisation principle.

55. ESMA considers that there are a number of arguments against exempting FoP securities transfers as a whole, irrespective of the parties concerned:

a. Without further specification of what should be captured under this exemption, it would cover a wide range of activities. Whereas some of these activities could not be considered as trading (such as administrative transfers or technical operations carried out by the CSD), many others would correspond to transfers of collateral that support trading activity. From that perspective, many of these FoP transfers are "non-trades" on which "real" trades depend.

b. Along the same line, it is important to keep in mind that a FoP settlement instruction may be the end result of actual trading activity. For instance, a FoP settlement instruction at CSD level can be the result of netting of several transactions[18].

c. These operations are carried out as a risk management function for which it is important that settlement takes place on a timely basis. ESMA agrees with the views expressed regarding the fundamental risk linked to the exclusion of FoP collateral transfer transactions as a whole in cases of late recalling of a securities lending transaction due to a sale, the cash claiming process vis-à-vis the lending counterparty could no longer be carried out[19].

56. In these cases, such broad exemption could breach the immunisation principle, potentially leading to financial stability implications if collateral is not delivered on time, as highlighted by the responses to the CP.

57. From an operational standpoint, the cost of putting such broad exemption in place may outweigh the benefits. Based on the data reported by CSDs under Article 7(1) of CSDR, ESMA notes that the number of instructions related to collateral management operations entered into the securities settlement systems operated by EEA CSDs is not very high (even if their value is high). Moreover, the settlement fail rates for collateral management operations are very low (see the charts below).

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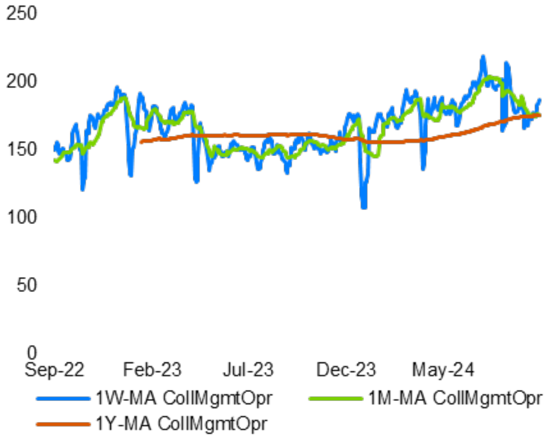
[18] For example, two parties, A and B, have multiple transactions involving various securities. Instead of settling each transaction individually, they agree to net the transactions. After netting, Party A owes Party B a certain number of shares of Security X, and Party B owes Party A a certain number of shares of Security Y. They decide to settle these netted transactions using FoP instructions.

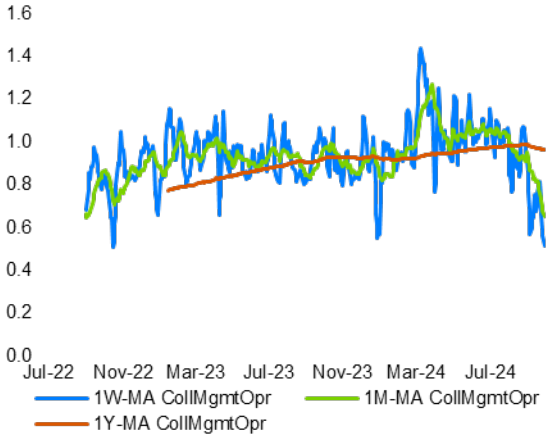
- **Party A** sends an instruction to deliver shares of Security X to Party B **Free of Payment**.
- **Party B** sends an instruction to deliver shares of Security Y to Party A **Free of Payment**.

This way, both parties exchange the netted securities without any cash payment involved, simplifying the settlement process.

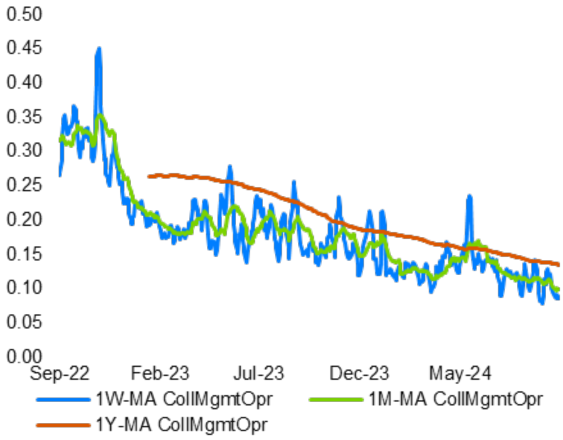
[19] Large beneficial owners (i.e., pension funds, endowments, mutual funds, insurance companies and other collective investment vehicles) that participate in securities lending enter into a securities lending authorization ("SLA") with a securities lending agent. The SLA authorizes the lending agent to lend the beneficial owner's securities to certain borrowers pursuant to an agreement that the lending agent, as agent for the beneficial owner, enters into with the borrower. The borrower agreement contains a contractual right allowing the lending agent, on behalf of the beneficial owner, and upon notice to the borrower, to demand the return of the security at any time.



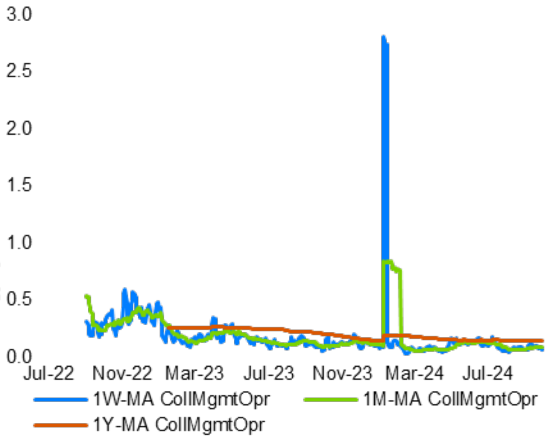
Note: Volume of settlement instructions at EEA level for collateral management operations, in thousand.
Sources: ESMA.



Note: Value of settlement instructions at EEA level for collateral management operations, in EUR tn.
Sources: ESMA.



Note: Settlement fails as a % of total volume of settlement instructions at EEA level for collateral management operations.
Sources: ESMA.



Note: Settlement fails as a % of total value of settlement instructions at EEA level for collateral management operations.
Sources: ESMA.

58. ESMA has also considered the **(de)mobilisation of collateral for ESCB credit operations or for any of the purposes listed in Annex V to Guideline ECB/2024/22**.

59. Such (de)mobilisation takes place in the context of the ESCB's objectives and tasks as defined in the legal framework [20]. Therefore, ESMA agrees that these circumstances should not be subject to the cash penalties regime. It is also worth noting that one of the purposes of the settlement discipline regime is to prevent systemic risks, mostly related to the potential spillover effect of settlement fails. In that respect, this risk is not

[20] Article 127 of the Treaty of the European Union[20], which defines as one of the basic tasks to be carried out through the ESCB defining and implementing the monetary policy of the Union. That provision is further developed in Article 18 of the Protocol on the statute of the European System of Central Banks and of the European Central Bank. This Article establishes that in order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral.
Finally, recital (8) of the Guideline (EU) 2024/[22] of the European Central Bank of 13 August 2024 on the management of collateral in Eurosystem credit operations (ECB/2024/22)[20] stipulates that "In addition to collateral mobilised for the purposes of collateralising Eurosystem credit operations, NCBs, at their discretion, may accept and manage collateral mobilised by counterparties *for any of the other purposes listed in Annex V to this Guideline* and should be able to rely on the services of the ECMS in that respect" (emphasis added).

relevant in these operations since central banks do not re-use or re-hypothecate collateral.

60. ESMA has also analysed the scope of this exemption and deleted the reference to “FoP securities transfers”, clarifying that the (de)mobilisation of collateral refers to “ESCB credit operations or for any of the purposes listed in Annex V to Guideline ECB/2024/22”. This wording would apply independently of the collateralisation arrangements.

61. Finally, ESMA would like to clarify whether this exemption applies to triparty agents, as requested by several market participants.

62. Market infrastructures and custodians have developed management systems that are capable of evaluating the consolidated need for collateral of their clients, selecting the assets that meet the eligibility criteria of counterparties and market infrastructures, pricing them and mobilising them, if necessary, by substituting assets on the basis of algorithms. These algorithms select, among the client's collateralizable assets, those which fulfil the eligibility criteria of the need to be covered, while being the cheapest to mobilise from the collateral giver's point of view.

63. Providers of triparty collateral management services (TCMS) - i.e. eligible triparty agents (TPAs) - may be used in the context of Eurosystem credit operations, both on a domestic and cross-border basis. Consistently with that approach, ESMA considers that the use of triparty collateral management services provided by triparty agents by the ESCB and its counterparties does not affect the nature of these operations and should be considered within the scope of this exemption[21], to the extent they represent ESCB credit operations or for any of the purposes listed in Annex V to Guideline ECB/2024/22.

64. Moving on to the next category of proposed exemptions, ESMA concludes that **market claims, corporate actions on stock such as cash distributions, securities distributions and reorganisations** should be excluded from the scope of cash penalties. These scenarios were widely supported by respondents, in particular by the CSD community, which considered that the logic (and the ISO transaction codes CLAI[22] and CORP) is already in place for corporate actions on stock and the implementation would not imply major complexities.

65. Following the request made for further specification of the cases covered under this exemption, ESMA wishes to clarify that the exemption should include the following cases:

[21] See Article 7 and Annex II to Guideline (EU) 2024/[22] of the European Central Bank of 13 August 2024 on the management of collateral in Eurosystem credit operations.
[22] This trading code is still to be implemented by T2S at the time of finalising this Report.

66. **Corporate actions on stock,** since they are actions initiated by a company that affect their securities, such as stock splits. Examples of these corporate actions are:

a. Cash distributions such as cash dividend and interest payment.

b. Securities distributions such as stock dividend and bonus issue.

c. Reorganisations such as conversion, stock split, redemption, tender offer.

d. Market claims include the reallocation of the proceeds of a distribution (such as dividends or interest payments) to the party that is contractually entitled to them.

67. Different approaches regarding the eventual inclusion of **transformations** in the scope of this exemption were noticeable. ESMA notes that transformations are the process of handling pending transactions that are affected by corporate actions[23]. When a corporate action, such as a merger or a stock split, occurs, it can impact transactions that have been initiated but not yet settled.

68. The transformation process involves two main steps:

a. Cancellation of the original pending transaction.

b. Creation of new transactions that reflect the terms of the corporate action.

69. ESMA notes that in practice, if a company X does a reorganisation and changes the ISIN or its terms, a pending transaction in ISIN A will be cancelled and replaced with a pending transaction on ISIN B. Any transaction that is pending after ISD on ISIN A will incur a cash penalty. Once it is transformed, it remains a pending transaction on ISIN B. ISIN A validity date for penalty eligibility will be set to the end of record date (Transformation date -1) so that there will not be double penalties.

70. However, the underlying transaction (now under ISIN B) remains and should be settled in time. Therefore, exempting transformations, i.e. exempting pending transactions under ISIN B due to a transformation, would disincentivise timely settlement. As a consequence, ESMA concludes that **transformations** should not be exempted.

71. ESMA remains of the view that the **process of technical creation of securities** should be exempted from the scope of the settlement discipline. ESMA understands that the technical creation of securities is the process of the initial recording of the securities in the issuer's account/ issuance account at CSD level.

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[23] Please see https://www.ecb.europa.eu/paym/target/t2s/governance/pdf/casg/ecb.targetseccasg161130_T2STransformationStandards.en.pdf?246adbe6ac422ab9d4c961ad69d34a5b. In particular, transformations are defined as "the 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".

72. The so-called “notary service” corresponds to the initial recording of newly created securities at the level of the CSDs or possibly specialised entities. It is one of the three core services provided by CSDs under CSDR. In most cases, CSDs are directly involved in the process of issuing securities, by holding issue accounts opened in the name of the issuers and handling the initial registration of the securities[24].

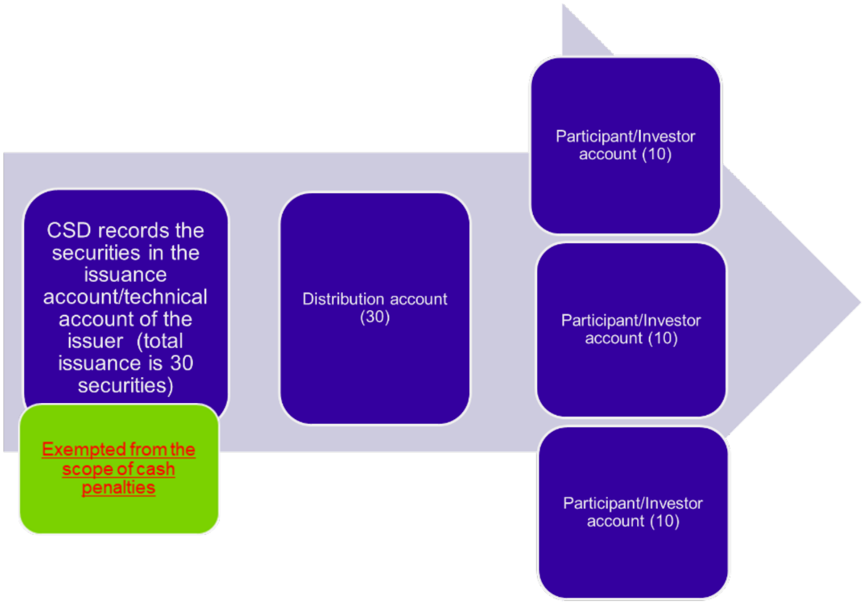
73. The operational process of setting-up a new security at a CSD[25] will include the creation either of an issuance account for that security, or of an equivalent technical mechanism for ensuring that for a specific ISIN there is a control on the total number of securities held within that CSD. An issuance account at a CSD is a technical securities account that records for a given security (i.e. a given ISIN) the total number of securities issued within that CSD. Issuance accounts at a CSD are distinct from investor or participant accounts, which record the amounts of securities held by different investors and may confer ownership rights subject to the applicable legislation.

74. After that, the financial instruments may be transferred (typically free of payment) from the issuance account to a “distribution” account, and then the settlement (against payment) of the primary market transaction takes place between the distribution account and the account of the investor. It is also possible to directly transfer the financial instruments from the issuance account to the participant/investor account.

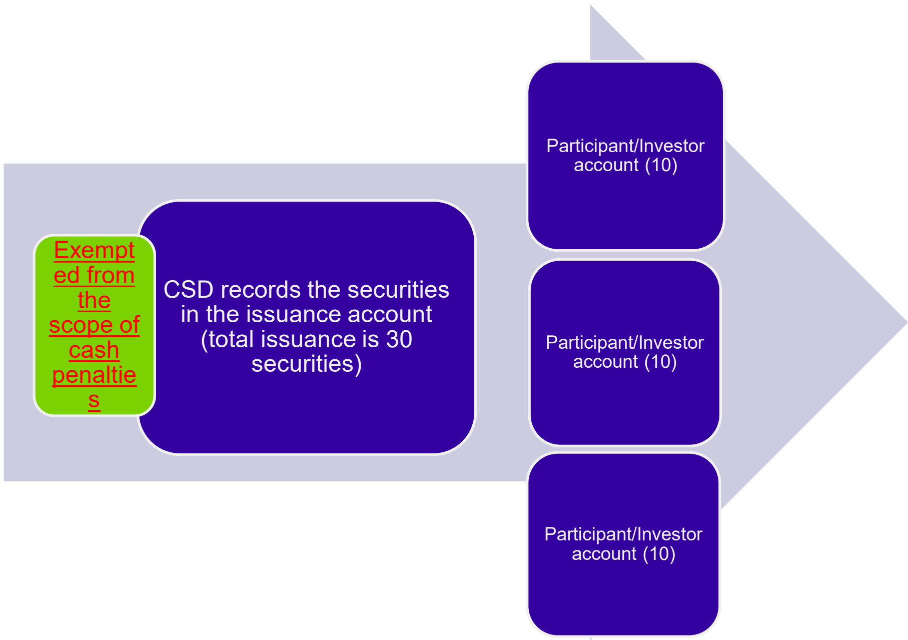
75. The feedback received clearly supported exempting the technical creation of securities. Any further transfers of the securities, including to distribution accounts used for primary market operations should be in scope of cash penalties. ESMA also notes that this approach is consistent with Article 5(2) of CSDR *in fine* that exempts the initial recording of transferable securities in book-entry form from T+2.

76. In line with that, the graphs below identify the steps that take place in the creation and distribution of securities (navy blue boxes) under the two main types of technical creation of securities currently used by CSDs. The green boxes identify the only step that should be exempted from cash penalties. ESMA acknowledges that the practical implementation of the exemption represented in the second diagram can be complex because the recording of the securities in the issuance account (debit) may be paired with a simultaneous credit (distribution) to the participant/investor account.

[24] Please see Banque de France’s Payments and Market Infrastructures in the digital era, page 191 onwards (payments_market.pdf)
[25] From European Post-Trade Forum, Annex 3, page 31 onwards (https://finance.ec.europa.eu/document/download/0481b029-e716-4474-9ac1-9b5819d7e26e_en?filename=170515-eptf-report-annex-3_en.pdf)



Source: ESMA



Source: ESMA

77. ESMA also considers that **share registrations** should be exempted from the scope of cash penalties. Share registration is the process of officially recording the transfer of ownership of shares from one party to another in the issuer's share register. One trade association noted that share registration process differs from the settlement process.

78. ESMA understands that this is the case. For share registration, a settlement instruction is sent as a tool to communicate shareholder information to registers but that settlement instruction does not entail a genuine settlement activity. In many cases, where a

registration order is sent to the CSD with the "same day" value after the CSD cut-off time, a "late settlement fail" penalty is generated. However, in these cases, debit and credit penalties apply for the same client, hence, there is no financial impact. It is also possible that the share registration 'fails' when the shares are not registered in the safekeeping account yet.

79. Even though share registration usually comes because of trading activity, the registration process is an independent process that should not be considered as such. Moreover, the feedback received indicates that a significant number of these cash penalties can be generated around the time of shareholder meetings without a meaningful purpose other than the administrative burden for market participants and financial market infrastructures.

80. Therefore, ESMA concludes that these cases should not be considered as trading.

81. A similar logic applies to the **creation and redemption of fund units on the primary market**, which also received wide support from market participants. ESMA agrees with the views considering that these processes are not 'trades' involving two trading parties. ESMA has also considered that in these cases, settlement penalties could negatively and unduly impact end investors by way of adding extra costs (penalty fees) or forced asset sales that could undermine the fund performance.

82. Regarding the **creation and redemption of ETFs**, it is essential to separate the various steps of the process. This approach aligns with the responses to the CP, which distinguish between "primary market transactions" and the technical creation of ETF shares.

83. This distinction is necessary to correctly apply the settlement discipline to the ETFs' creation and redemption process. As described by the Final Report on shortening the settlement cycle[26], ETFs' settlement fails amounted on average to 17.32% of the monthly total volume of ETFs settlement instructions at EEA level between June 2023 and May 2024, representing 19.27% of the value.

84. Typically, when an issuer of a physically replicating ETF wants to create new shares, whether to launch a new product or meet an increasing market demand, it turns to a designated market maker or authorized participant. It is the authorised participant's role to acquire the securities that the ETF will hold. For instance, if an ETF is designed to track the XYZ 50 Index, the authorized participant will buy shares of all the index constituents in the exact same weight as represented in the index[27], then deliver those shares to the ETF issuer. In exchange, the ETF issuer gives to the authorized participant a block of equally valued ETF shares, called a creation unit. The exchange

[26] Please see https://www.esma.europa.eu/sites/default/files/2024-11/ESMA74-2119945925-1969_Report_on_shortening_settlement_cycle.pdf, footnote 51.

[27] ESMA notes that it might not always be the case as ETFs use a tracking error which may allow them to deviate (to a certain extent) from the performance of the tracked index.

takes place on a one-for-one market-value basis: the authorized participant delivers a certain number of underlying securities and receives in subscription the exact same value in ETF shares, priced based on their net asset value (NAV), and not on the market value at which the ETF shares are traded[28].

85. An ETF may be able to replicate the index performance by using swaps. Synthetic replication involves the use of these derivative contracts, which are agreed between the ETF and a counterparty, or multiple counterparties, for the exchange (swapping) of cashflows. The ETF would typically receive the precise index performance, minus a fee for the swap contract. Authorised participants assigned to synthetic ETFs typically pay for a creation unit with cash. In that instance, the ETF issuer buys any required securities or adjusts the swap agreement that delivers the ETF's return.

86. ESMA considers that the delivery of securities (or cash, in the case of synthetic ETFs) by the authorised participant to the ETF issuer constitutes a preliminary step of "primary market transactions". ESMA considered the possibility of exempting the transfer of assets or cash to pay the newly created ETF shares, since it is arguable that these are not 'transactions' as such and they are intrinsically related to the technical creation of the ETF shares.

87. However, ESMA concludes that this step should remain within the scope of CSDR cash penalties. As highlighted in one of the responses to the CP and the feedback received from the Call for Views on the Shortening of the Securities Settlement Cycle, ETF issuances are prone to delays due to the challenge of arranging the delivery of a complex set of underlying instruments. Cash penalties create a natural incentive for automation and accelerating processes: when the non-issuance of ETF shares is caused by the partial non-delivery of the underlying financial instruments, the authorised participant's cash penalty shall not be totally compensated by the penalty(ies) imposed to the seller(s) of those financial instruments.

88. ESMA remains of the view that T+1 will only be achieved for ETFs if all the steps of the process (including the preliminary steps) are accelerated. Therefore, delays in the preliminary steps (and more specifically during the transfer of the assets/cash from the authorised participant to the ETF issuer/Transfer agent and during the verification carried out by the ETF issuer/transfer agent of the assets/cash transferred) may delay the entire process. Therefore, these preliminary steps should also be subject to a cash penalty for missing the intended settlement date[29].

89. The next step is what can be properly considered as the technical creation of ETFs shares, i.e. once the ETF issuer/transfer agent has verified the assets transferred by

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[28] Page 124 of Annex 3 of European Post-Trade Report https://finance.ec.europa.eu/document/download/0481b029-e716-4474-9ac1-9b5819d7e26e_en?filename=170515-eptf-report-annex-3_en.pdf.

[29] See paragraphs 87, 133 and 173 of ESMA Final Report on Shortening the Securities Settlement Cycle (https://www.esma.europa.eu/sites/default/files/2024-11/ESMA74-2119945925-1969_Report_on_shortening_settlement_cycle.pdf).

the authorised participant, it instructs the CSD to record the issuance of these shares in the ETF issuer's CSD[30] account or in the transfer agent's CSD account[31].

90. In the case of redemption, the ETF issuer verifies the amount of ETF shares gathered by the authorised participant and provides it with a basket of underlying securities[32]. The CSD then eliminates the ETF shares from the ETF issuer's or transfer agent's CSD account.

91. There are different arguments supporting the exemption of the technical creation/redemption of ETFs shares in the ETF issuer's/transfer agent's account at the CSD from the scope of cash penalties:

a. First of all, the underlying reasoning is fully consistent with the other cases of technical creation of securities: crediting the ETF shares to the ETF issuer's/transfer agent's CSD account after the delivery of the basket of underlying securities/ETF shares/cash cannot be considered as "trading", since the collection/acquisition of the basket of securities/ETF shares/cash took place at a previous stage. In this sense, ESMA notes the almost unanimous support to this exemption in the responses to the CP.

b. Anecdotal evidence gathered in the course of the consultation also suggests that these transactions hardly fail.

c. ESMA agrees with the view expressed by one of the respondents who noted that financial penalties can reduce the efficiency of the ETF by adding extra costs that will be ultimately passed on to investors via wider spreads.

d. The technical complexity of exempting the creation and redemption of fund units and other securities but not ETFs may be excessive. As noted by some responses to the consultation, due to the sheer number of cases in which these "non trading" exemptions occur, CSDs will be forced to implement ex-ante filters. In itself, the exemption of the creation and redemption of fund units is already complex, due to the non-standardised use of the ISO transaction codes 'SUBS' and 'REDM'[33]. However, if the technical creation of ETFs remains in the scope of cash penalties, CSDs should not only filter on the basis of the type of transaction but also based on the asset type.

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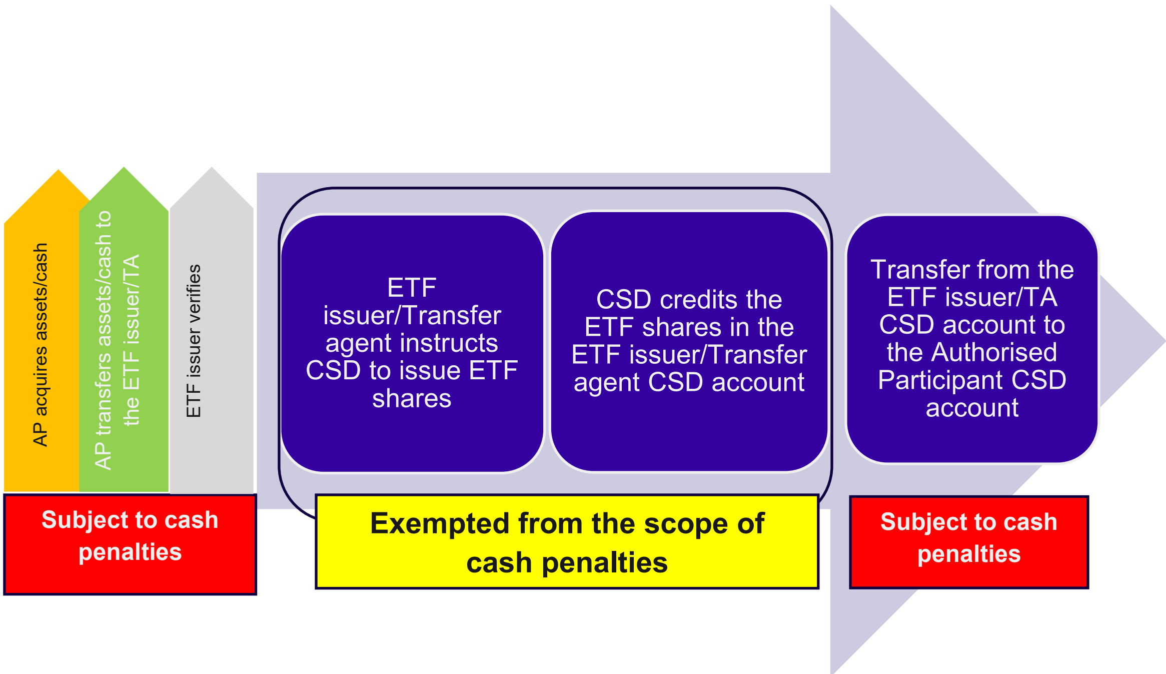
[30] For a full description of the different types of issuance/redemption models, see Annex 3 of the European Post-Trade Report, page 118 onwards.
[31] In some cases, the ETF issuer may use a transfer agent to manage the ETF shares. The CSD facilitates this crediting process, ensuring that the shares are accurately recorded in the transfer agent's account.
[32] This description corresponds to the "CSD model", as opposed to the "Transfer Agent" model, where authorised participants deliver a basket of securities to the ETF's custodian and in return, they receive ETF shares. Conversely, for redemptions, authorised participants return ETF shares to the transfer agent and receive the underlying securities. For more information about the CSD model and the transfer agent model, see Annex 3 of the Report of the European Post-Trade Forum (https://finance.ec.europa.eu/publications/report-european-post-trade-forum-eptf_en).
[33] For instance, anecdotal evidence gathered by ESMA suggests that some market participants use the code TRAD (regular trade) instead. https://www.iso20022.org/15022/uhb/mt515-6-field-22f.htm

92. Consequently, ESMA concludes that the technical creation/redemption of ETF shares between the ETF issuer/transfer agent and the CSD should be excluded from the scope of CSDR cash penalties, in line with any other securities.

93. To conclude the description of the ETFs creation/redemption process, there is a third step of the "primary market" transactions whereby the ETF shares are transferred from the ETF issuer's/transfer agent's CSD account to the authorised participant's CSD account. In the case of redemption of ETF shares, the underlying financial instruments are transferred from the ETF issuer's or transfer agent's CSD account to the authorized participant's account.

94. ESMA considers it important to highlight that this third step should remain within the scope of cash penalties, in line with the conclusions reached in ESMA's Final Report on Shortening the Securities Settlement Cycle[34].

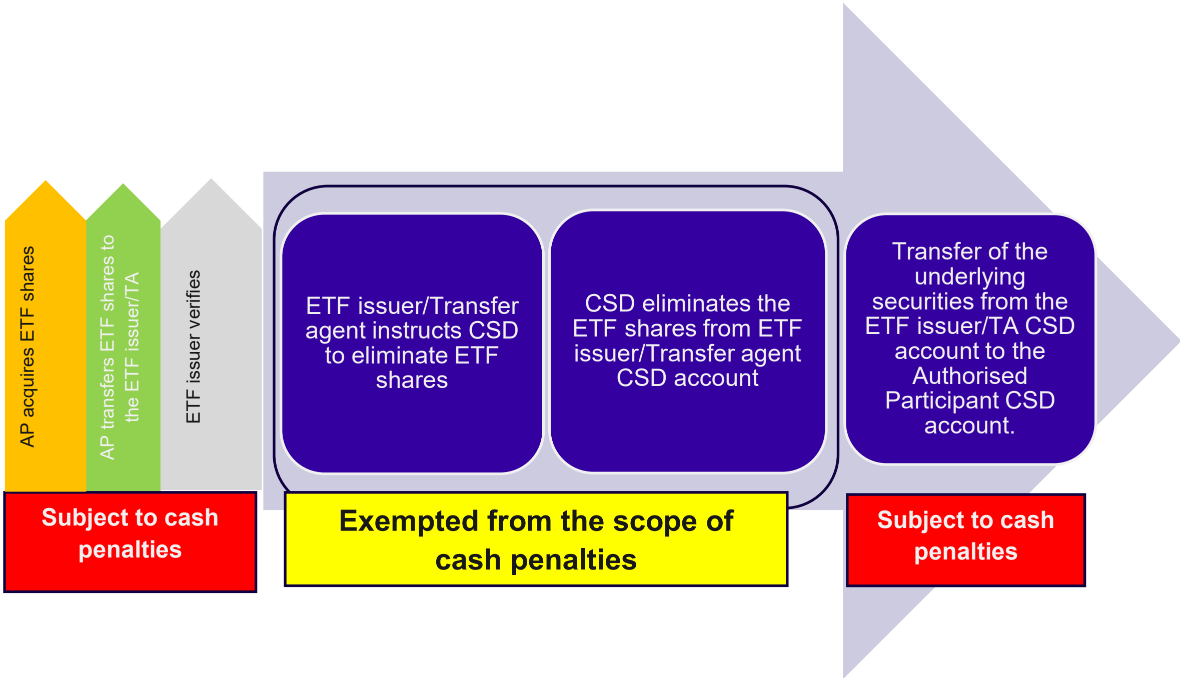
Creation of ETFs shares



Source: ESMA

[34] Section 3.3 of ESMA's Report on assessment of the shortening of the settlement cycle.

Redemption of ETFs shares



Source: ESMA

95. Finally, ESMA concludes that "technical realignment operations between CSDs including T2S technical realignment operations" should be left out of scope of cash penalties.

96. In general, a realignment is the process of adjusting the positions of securities across different accounts or CSDs to ensure accurate settlement. This process is necessary when securities need to be transferred between different CSDs or accounts without changing the beneficial ownership of the securities. Technical realignment between CSD accounts is a technical step to ensure settlement via CSD links and the trigger behind can be a trade, but there are other bookings on the participants account which reflect that trade, and the technical realignment is just the mirroring of this between CSDs. This would include, 'technical T2S realignment operations' which consist of the automated generation of realignment instructions by T2S to facilitate cross-CSD settlement. This ensures that securities are correctly positioned between different CSDs involved in the settlement process.

97. As described by the T2S Operator in their contribution to the CP, "the rationale for this exemption is that in a T2S cross-CSD transaction, the delivering and receiving CSD participants can be identified, and the cash penalty does not need to be passed on through the chain of Issuer/Investor CSDs".

98. ESMA also agrees with the views expressed by other respondents which differentiated between a T2S realignment and a participant's realignment. The latter takes place

when a participant moves a position between its own CSD accounts to facilitate settlement and avoid lack of securities. While there are arguments supporting the exemption (participant realignments are not "trades" and when the participant realignment settles after the ISD the party who pays the penalty is the one that receives it), ESMA agrees that the costs of implementing such an exemption might outweigh the benefits.

99. In conclusion, ESMA considers that technical realignment operations between CSDs, including T2S technical realignment, should be excluded from the scope of settlement discipline.

100. Apart from the cases put forward in the CP, ESMA considers it necessary to analyse whether two additional cases should be excluded from the scope of settlement discipline.

101. In principle, **portfolio transfers and transfers of securities without change of beneficial ownership** could be excluded from the scope of settlement discipline mostly because the same participant (or underlying client) is usually the payer and the receiver of the respective penalties. However, ESMA notes that there are elements playing against their exclusion:

102. ESMA notes that, in practice, imposing this exemption would not have a meaningful impact given that, in the unlikely event of a settlement fail, the payer and the receiver of the penalty will be the same person.

103. Imposing an exemption would create additional complexities for CSDs due to the diverse trading codes used for these purposes. Despite a significant number of responses noted that it is possible to operationalise this exemption by filtering ISO codes such as No Change of Beneficial Ownership (NCBO), portfolio transfer (PORT), external account transfer (OWNE) or internal account transfers (OWNI), again the lack of harmonisation in the use of these transaction types could generate additional complexity. This point was recognised by the supporters of this exemption.

104. ESMA did not find sufficient evidence or support for other proposals coming from the responses to the CP such as those regarding testamentary transactions or securities movements at CSDs reflecting the registration of securities positions and transfers of securities between a depository receipt (DR) issuer and an investor as part of the process of converting underlying securities into DRs or DRs into the underlying securities.

105. Therefore, and in line with the overall objective of simplification and burden reduction, ESMA is of the opinion that the following circumstances should not be considered as trading for the purpose of the application of cash penalties and the MBI:

a. (De)mobilisation of collateral for ESCB credit operations or for the purposes listed in Annex V to Guideline ECB/2024/22;

b. Market claims and corporate actions on stock such as cash distributions (including cash dividend, interest payment), securities distributions (including stock dividend, bonus issue) and reorganisations (including conversion, stock split, redemption, tender offer);

c. The process of technical creation of securities, i.e. the transfer from the CSD's issuance account to the issuer/issuer's agent CSD account or the initial recording of securities in the issuer/issuer's agent CSD account;

d. Share registration, i.e. the process of officially recording the transfer of ownership of shares from one party to another in the issuer's share register maintained by the CSD;

e. The process of technical creation and redemption of fund units or shares on the primary market (including ETFs shares), i.e. the crediting (in the case of creation) or the debiting/elimination (in the case of redemption) of the fund units or shares from the fund/transfer agent CSD account;

f. Technical realignment operations between CSDs including T2S technical realignment operations.

5 Immunisation principle in relation to settlement fails that are not attributable to the participants in the transactions and circumstances not considered as trading

106. ESMA asked several questions regarding the immunisation principle in the CP that were addressed by different stakeholders. Those responses were summarised in the previous sections.

107. ESMA considers it necessary to make some clarifications, in line with some responses to the CP underlining that the so-called immunisation principle is not an absolute principle:

a. First of all, the immunisation principle, which derives from Article 7(2) of CSDR[35] and recital (16) of CSDR[36], merely implies that, by crediting the cash penalty paid by the failing participant to the non-failing participant, the penalty paid by one

[35] For each securities settlement system it operates, a CSD shall establish procedures that facilitate settlement of transactions in financial instruments referred to in Article 5(1) that are not settled on the intended settlement date. These procedures shall provide for a penalty mechanism which will serve as an *effective deterrent for participants that cause settlement fails*. (…) The penalty mechanism referred to in the first subparagraph shall include *cash penalties for participants that cause settlement fails ('failing participants')*. (…). *The cash penalties shall not be configured as a revenue source for the CSD*. [emphasis added]

[36] *Cash penalties imposed on failing participants should, where possible, be credited to the non-failing clients as compensation* and should not, in any event, become a source of revenue for the CSD concerned. [emphasis added]

participant will be offset by the penalty they receive from another participant *in a chain of settlement fails*.

b. Second, the risk of one participant becoming a net payer in a chain of transactions exists in all cases. In the example presented by one respondent, even in the case of settlement instructions involving securities or issuers under sanctions or anti-money laundering proceedings, there is still the risk that a party with a DvP transaction in a security under sanctions suffers a penalty for a receipt against payment transaction in another security not subject to sanctions. This second transaction may fail because of insufficient cash due to the non-settlement of the prior transaction in the sanctioned security.

c. Third, some participants may become net payers of cash penalties in any case because, in a chain of transactions, penalties have different calculation methodologies depending on different parameters (quantity of failed securities, price of the ISIN, etc.). As a consequence, the cash penalties paid, and the cash penalties received may not be the same.

108. Accordingly, ESMA concludes that the main purpose of the cash penalty regime is to incentivise settlement efficiency, even at the cost that, in certain cases, specific participants may become net payers of penalties. Therefore, the exemptions proposed in this technical advice (both for causes not attributable to the participants and for the circumstances not considered as trading) should only benefit the individuals directly affected by the relevant case.

6 Practical implementation of the exemptions to the scope of settlement discipline: ex-ante filtering

6.1 Background

109. According to the EC mandate, the proposed technical advice “should not lead to further fragmentation of the single market for capital, while the identification of the relevant transactions and operations should lend itself to automation by CSDs to ensure the seamless and cost-effective operation of post-trade infrastructures. The advice provided should reduce compliance costs and regulatory burden put on CSDs and participants to the securities settlement system, without jeopardizing financial stability and resilience of the EU capital markets”.

110. As requested by the EC mandate, ESMA has considered the practical implementation of the proposed changes, in the broader context of other structural changes impacting the trading and settlement cycles.

111. The CP proposed a set of cases that could be exempted from the scope of the settlement discipline while noting that, ideally, CSDs should be able to process them on an automated basis based on information available in their systems.

112. However, ESMA also acknowledged that CSDs might not always have the information needed to process these cases on an automated basis in their systems and identified, as a possible way to address that problem, making mandatory filling in the transaction type in the settlement instruction.

113. Currently, there are 43 codes in T2S that can be used to fill the securities transaction type code “CD_SEC_TX” field, specifying the type of transaction from which the settlement instruction stems. ESMA requested stakeholders’ views on which transaction types based on the codes allowed by T2S (or potentially other codes such as ISO transaction codes) should be exempted from settlement discipline measures.

6.2 Feedback to the consultation

6.2.1 Practical implementation of exemptions based on underlying causes of settlement fails that are considered as not attributable to the participants in the transactions

114. In general terms, most respondents expressed their preference for exemptions to be applied ex-ante in an automated way. For these respondents, CSD bilateral ex-post appeals should be restricted to penalties that were correctly applied in accordance with the information that was available to the CSD at the time of the calculation.

115. They generally indicated that ex-post exemptions through the appeal mechanism at CSDs are particularly burdensome and may imply greater operational costs than the value of the penalty itself. As a consequence, they should be avoided whenever possible.

116. At the same time, most financial market infrastructures replying to the CP did not identify benefits in changing the (ex-post) way in which these scenarios are currently handled by them. They recommended that each CSD should undertake a cost-benefit analysis to assess the impact of changes in handling of exceptions.

117. This approach was justified by some financial market infrastructures on the limited number of instances in which these exemptions are applied. Other trade associations and market participants supported this view. One of them noted that CSDs are usually proactive in removing penalties for current exemptions.

118. Regarding the **proposed exemptions that cannot be filtered ex-ante**, three cases strongly arise from the responses to the consultation: i) the exemption due to ISIN suspension, ii) technical impossibilities at the CSD level, and iii) settlement instructions put on hold due to measures from courts or administrative bodies.

6.2.2 Practical implementation of exemptions based on the circumstances in which the operations are not considered as trading

119. Most of the responses received reiterated that automated ex-ante filtering would lead to clarity, long-term greater operational efficiency and cost savings, avoiding the complications and inefficiencies derived from the administrative burden from manual interventions. However, they did not specify any potential related costs.

120. In line with the questions in the CP, there was broad support for using the transaction type code as the best way to identify operations not considered as trading. However, ESMA also received strong concerns about the possibility of making the transaction type a matching criterion.

121. Support for the transaction type as method to ex-ante filter 'non-trading' operations was not unanimous, though. Some stakeholders expressed strong concerns because the primary consideration is whether the type of operation proposed to be exempted:

   a. can be identified unequivocally; and

   b. can be filtered ex-ante by the penalty mechanism (i.e. built into the design), in order to be operationally manageable given the potential volumes of instructions to exempt and to avoid any manual intervention.

6.3 ESMA's assessment and final approach

6.3.1 Practical implementation of the exemptions based on underlying causes of settlement fails that are considered as not attributable to the participants in the transactions

122. Apart from the strong request for ex-ante filtering in all the cases where it is technically possible from most of the responses, ESMA notes the preference expressed by the CSD community to carry out ex-ante filtering of causes of settlement fails not attributable to the participants only where it is economically efficient. At the same time, some of them did not consider it necessary to change the management of these cases, which are currently handled through ex-post bilateral claims. Some CSDs proposed to focus on improving settlement efficiency in the context of the transition to T+1.

123. The responses to the consultation did not provide any quantitative evidence for ESMA to assess the number of instances in which each of the proposed exemptions occur. However, incidental evidence gathered by ESMA to prepare this Final Report indicates that the number of these fails is low, potentially making a compulsory ex-ante filtering of these cases economically inefficient.

124. In addition to that, part of the feedback received underlined that ex-ante filtering might not be possible in the following cases: ISIN suspension from trading, technical

impossibility at the CSD level, and instructions put on hold following an order issued by a court or another authority.

125. As regards **ISIN suspension from trading in the most relevant market in terms of liquidity for at least one trading day**, there are different elements supporting the ex-post management of these cases, at least for the time being:

126. CSDs currently monitor FIRDS to identify the ISINs that can be settled. ESMA acknowledges that crossing the data from FIRDS and SARIS[37] to carry out an ex-ante filtering of those exemptions could be costly for CSDs. This cost could be excessive for certain CSDs in the broader context of structural changes to transition to a shorter settlement cycle[38].

127. It may not be reasonable to require CSDs to implement such structural changes at this stage, considering other ongoing developments that could enhance ex-ante filtering in the future. Specifically, it could be examined whether the consolidated tape[39] might also support ex-ante filtering once it is fully deployed and the transition to T+1 is completed.

128. At this stage FIRDS and SARIS provide evidence to easily manage potential ex-post bilateral claims.

129. Therefore, ESMA concludes that CSDs should determine whether the benefit of ex-ante filtering of this exemption outweighs the costs of implementing it.

130. ESMA also agrees that the **technical impossibility at the CSD level** (as it corresponds to unexpected circumstances for the CSD itself) and **instructions put on hold following an order issued by a court or another authority** should be addressed by ex-post bilateral claims.

131. Given that the cases where ex-ante filtering would be possible are limited at this stage, ESMA does not recommend any regulatory action as regards ex-ante filtering of these cases. CSDs are free to set up arrangements for the ex-ante filtering of those exemptions subject to their own cost benefit analysis, taking into account the number of cases to be processed.

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[37] From a technical point of view, ESMA currently provides information about the trading venue(s) where a financial instrument is traded (through FIRDS), the identification of the most relevant market in terms of liquidity through the Financial Instruments Transparency System (FITRS) and also information regarding the suspensions covered by Articles 32 and 52 of MiFID II (Suspension and Restoration Information System [SARIS]) free of charge in a machine-readable format.

[38] EC proposal to amend Article 5(2) of CSDR: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52025PC0038 and ESMA's Final Report on Shortening the Securities Settlement Cycle (https://www.esma.europa.eu/sites/default/files/2024-11/ESMA74-2119945925-1969_Report_on_shortening_settlement_cycle.pdf).

[39] https://www.esma.europa.eu/sites/default/files/2024-12/ESMA74-2134169708-7768_-_MiFIR_review_-_Final_Report_on_CTPs_and_DRSPs.pdfhttps://www.esma.europa.eu/sites/default/files/2024-12/ESMA74-2134169708-7768_-_MiFIR_review_-_Final_Report_on_CTPs_and_DRSPs.pdf; see for instance the field "Instrument Status" https://www.esma.europa.eu/sites/default/files/2024-12/ESMA74-2134169708-7768_-_MiFIR_review_-_Final_Report_on_CTPs_and_DRSPs.pdf; see for instance the where the following possible cases are possible: 'SUSP' – the instrument is suspended 'REMV' – the instrument is removed 'HALT' – the instrument is subject to a trading halt 'ACTV' - the instrument is available for trading after a suspension, removal or halt.

6.3.2 Practical implementation of the exemptions based on circumstances in which operations are not considered as trading

132. ESMA recommends CSDs to take the necessary steps to ex-ante filter settlement instructions that have identical transaction codes corresponding to the list of exemptions based on operations that are not considered as trading.

133. However, ESMA does not think that the transaction type should become a mandatory matching field, given that it may lead to an increase in settlement fails, due to inconsistencies in the usage of transaction codes by CSD participants.

134. ESMA considers that there are several arguments supporting the ex-ante filtering on the basis of identical trading codes:

    a. Firstly, it would imply an effective cost reduction for CSDs' participants.

    b. Secondly, it would imply a cost reduction for CSDs as well. ESMA has engaged with the CSD community in the preparation of this Final Report to clarify the operational impact of applying ex-ante filtering in the case of operations not considered as trading. ECSDA confirmed that, due to the number of cases in which it would be necessary to apply these exemptions, it would be too costly to manage them by means of ex-post bilateral claims.

    c. Thirdly, ESMA understands that its proposal should be an easily implementable solution based on the current capabilities/features of CSDs and T2S. The responses provided by the CSD community and the T2S Operator consistently consider that the only practicable means to achieve such systematic ex-ante filtering is to require both participants' settlement instructions to include identical transaction type codes. Such a change should imply an effective reduction in the costs derived from the management of bilateral claims by means of changes of low/medium complexity.

    d. Fourthly, this approach would also meet the requirements set forth by CSDs for the implementation of the exemptions: (i) such cases should be identified unequivocally, and (ii) they should be integrated into the design of the penalty mechanism to ensure operational manageability given the potential volume of instructions to exempt.

    e. Finally, this approach would have no impact on the mandatory matching fields for settlement. As a consequence, it would not lead to an increase in settlement fails and it would incentivise the use of the transaction type code more consistently.

135. However, it may be possible to adopt a different approach with respect to the (de)mobilisation of collateral for ESCB credit operations and for the purposes listed in Annex V to Guideline ECB/2024/22.

136. ESMA understands that its proposal in relation to the (de)mobilisation of collateral for ESCB credit operations or the purposes listed in Annex V to Guideline ECB/2024/22 requires a prior harmonisation in the use of codes to ensure that the intended exemptions are identified correctly and consistently. A series of transaction type codes (CNCB, COLI, COLO, REPU) are already in use. However, some of these codes are also used in transactions between private parties. A harmonisation in the use of codes in the context of (de)mobilisation of collateral for ESCB credit operations or for other purposes listed in Annex V of Guideline ECB/2024/22 is therefore needed.

137. At the same time, it was suggested that identifying the accounts used for this purpose could potentially be an alternative to using the transaction type code. For example, one NCB reports that securities transfers to/from a pledge account, used as collateral, are conducted through a single-purpose account dedicated solely to ESCB credit operations. Therefore, it could be investigated whether it is possible to ex-ante exclude transfers to/from these accounts from cash penalties.

138. ESMA suggests investigating these types of solutions for the (de)mobilization of collateral within the context of ESCB credit operations, or for the purposes outlined in Annex V of Guideline ECB/2024/22.

139. ESMA considers it necessary to highlight that CSDs and their participants should maintain the capacity to manage these exemptions by means of ex-post bilateral claims where it has not been possible to apply the ex-ante filter[40]. On the basis of the feedback received, the expectation is that the number of these ex-post claims should decrease once the ex-ante filtering is in place.

140. It should be assessed whether a regulatory requirement should be introduced in the legal framework at a later stage.

6.3.3 Practical implementation of the exemptions from settlement discipline: entry into application

141. As a starting point, it is necessary to differentiate between the entry into application of: a) the settlement fails the underlying causes of which are not attributable to the participants, and b) the operations not considered as trading.

142. ESMA considers that the entry into application of the exemption for settlement fails the underlying causes of which are not attributable to the participants should start within the regular deadline (e.g. 20 days after publication of the Commission Delegated Act in the Official Journal of the EU). There is no reason for delaying the entry into application since ESMA understands that the proposal is consistent, in broad terms, with the current market practice (based on the existing CSDR Q&As).

[40] The exemption referring to share registrations may well be such a case.

143. Conversely, for operations not considered as trading, ESMA believes that the exemptions should become applicable at least 12 months after the publication of the Commission Delegated Act in the Official Journal of the EU, and no later than by the end of Q2 2027.

144. ESMA has requested the views of CSDs on the time needed to implement ex-ante filters for the management of these exemptions. The feedback received has indicated that 12 months could be enough time to implement the changes. They also noted that the start of the application of these exemptions should take place by the end of Q1 2027, in order not to overlap with the final preparations (including IT testing and implementation) for the move to T+1. However, ESMA also considered the views from the T2S Operator that requested to factor in the T2S bi-yearly release schedule (Nov/June).

145. ESMA agrees that the application of these exemptions before the ex-ante filters are in place would imply an excessive cost for both CSDs and their participants. The exemptions would be applicable to a high number of instances that should be managed by means of ex-post bilateral claims.

146. At the same time, given that the transition to T+1 will entail other structural changes for CSDs, ESMA agrees that the changes related to the application of the ex-ante filters for the scope of settlement discipline should be implemented before the T+1 related technical changes have to be implemented.

6.3.4 Practical implementation of exemptions based on underlying causes of settlement fails that are considered as not attributable to the participants in the transactions

147. At this stage, ESMA does not recommend ex-ante filtering of settlement fails the underlying causes of which are not attributable to the participants to the transactions. It should be left to the individual CSDs to determine whether setting up ex-ante filters compensates the cost of dealing with ex-post bilateral claims on an on-going basis.

6.3.5 Practical implementation of exemptions based on the circumstances in which operations are not considered as trading

148. ESMA recommends CSDs to take the necessary steps to ex-ante filter settlement instructions that have identical transaction codes corresponding to the list of exemptions based on operations that are not considered as trading.

149. ESMA does not think that transaction type should become a mandatory matching field, given that it may lead to an increase in settlement fails, due to inconsistencies in the usage of transaction codes by CSD participants.

150. ESMA also recommends exploring the possibility of ex-ante filtering of (de)mobilisation of collateral in the context of ESCB credit operations or for the purposes listed in Annex V to the Guideline ECB/2024/22 on the basis of the accounts.

151. ESMA notes that CSDs and participants should maintain the capacity to manage these exemptions by means of ex-post bilateral claims where it has not been possible to apply the ex-ante filter.

152. It should be assessed whether a regulatory requirement should be introduced in the legal framework at a later stage.

6.3.6 Practical implementation of the exemptions from settlement discipline: entry into application

153. The application of the exemptions in the case of settlement fails the underlying causes of which are not attributable to the participants should start within the regular deadline (e.g. 20 days after publication of the Commission Delegated Act in the Official Journal of the EU).

154. For operations not considered as trading, ESMA believes that the exemptions should become applicable at least 12 months after the publication of the Commission Delegated Act in the Official Journal of the EU, and, to the extent possible (subject to the date of publication of the Commission Delegated Act in the Official Journal of the EU), no later than by the end of Q2 2027.

7 Alignment between the scope of cash penalties and the mandatory buy-in regime

7.1 Background

155. The EC's request also mentions that "ESMA should also consider whether the specific conditions for exemptions of a particular transactions and/ or operation equally justify exemption from both the cash penalties regime as well as the mandatory buy-in process".

156. The CP reminded that, under Article 7a(7), point (a), of CSDR, as amended by CSDR Refit, the settlement fails, operations and transactions listed in Article 7(3) CSDR, as amended by CSDR Refit covering exemptions from cash penalties are also exempted from the mandatory buy-in (MBI).

7.2 Feedback to the consultation

157. This issue raised considerable attention from the respondents in their responses in relation to the **causes of settlement fails not attributable to the participants**.

158. Several responses supported the alignment between the scope of the cash penalty regime and the MBI regimes but considered that additional cases should be added to the MBI regime. One financial market infrastructure supported full alignment between the cash penalties, the MBI and the settlement fails reporting.

159. Some associations and market participants were contrary to the alignment noting that the underlying logic and the cases in which penalties apply do not always overlap with the cases where MBI applies. For example, one of them considered that when an ISIN is suspended or removed from trading it might not be necessary to suspend the cash penalty regime but there is a strong rationale for suspending the buy-in obligations, as it would not be possible to carry it out the buy-in.

160. However, both approaches coincided in requesting a specific consultation on the cases exempted from the MBI if such regime is implemented in the future.

161. One reply provided a comprehensive breakdown of the transaction type codes that should be exempted from the MBI regime[41], broadly in line with their ample interpretation of the circumstances that are not considered as trading. In particular, this association considered that margin transfers should not be excluded from the scope of cash penalties but should be exempted from the MBI because the receiving party has alternative means to manage the credit risk on a failed transaction (triggering a default notice, close-out netting, etc.).

7.3 ESMA's assessment and final approach

162. Firstly, ESMA notes that the replies received regarding the **circumstances in which operations are not considered as trading** do not differ on whether certain of these operations should be excluded from the scope of the MBI but on how broad this category should be.

163. Secondly, ESMA also notes the diverse feedback received in the case of underlying **causes of settlement fails not attributable to the participants**. The proposal received considerable support (to be complemented with additional cases). However, a significant number of respondents supported different scopes between the cash penalties regime and the MBI. ESMA would like to underline that this approach

[41] The list of transaction codes that according to this association should be exempt from the MBI regime are: COLI, COLO, CONV, ETFT, FCTA, INSP, ISSU, MKDW, MKUP, NSYN, OWNE, OWNI, PORT, REAL, REDI, REDM, RELE, RODE, SBRE, BLRE, SUBS, SYND, TBAC.

questions Article 7a(7)(a) of CSDR Refit, which establishes the alignment between both regimes.

164. Therefore, it does not seem possible to de-couple the scope of both regimes. ESMA considers that the scope of the cash penalties and the MBI should coincide as regards settlement fails not attributable to the participants, without prejudice of additional causes that should be consulted if necessary.

165. As regards the point made by several stakeholders in relation to additional cases that should be exempted from the MBI, Article 7a(7) of CSDR Refit provides for such additional exemptions[42] .

166. Therefore, ESMA believes that a consultation on additional cases should take place, if necessary, in accordance with Article 7a (15) of CSDR Refit[43].

167. ESMA concludes that settlement fails due to underlying causes that are considered as not attributable to the participants in the transactions, and the circumstances that are not considered as trading shall be exempted from both cash penalties and MBI, given the Level 1 provisions.

8 Annexes

8.1 Annex I – Summary of CP questions

A) Underlying causes of settlement fails that are considered as not attributable to the participants in the transactions.

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

168. As regards the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions, the vast majority of the CP responses supported the proposals, with a number of comments addressing specific elements of the proposals.

[42] The mandatory buy-in process referred to in paragraph 4 shall not apply to:
(a) the settlement fails, operations and transactions listed in Article 7(3);
(b) securities financing transactions;
(c) other types of transactions that render the buy-in process unnecessary;
(d) transactions that fall within the scope of Article 15 of Regulation (EU) No 236/2012.

[43] ESMA shall, in close cooperation with the members of the ESCB, develop draft regulatory technical standards to further specify:
(d) other types of transactions that render the buy-in process unnecessary as referred to in paragraph 7, point (c), such as financial collateral arrangements or transactions that include close-out netting provisions;

169. Several financial market infrastructures, market participants and the T2S Operator noted that CSDs are not informed about **trading suspensions**. They rely on ESMA's Financial Instrument Reference Data System (FIRDS) database to identify the ISINs that can be settled, which does not identify suspended instruments. Therefore, they suggested that, if this underlying cause is maintained, the relevant ISIN should appear in FIRDS as "invalid" or be removed from FIRDs.

170. Moreover, other respondents noted that suspension of trading on a trading venue does not result in a suspension of settlement across the board, since CSDs could still settle transactions on the same ISIN coming from other trading venues where the same instrument is traded and/or from over-the-counter (OTC) transactions. ESMA received two proposals to streamline this case:

a. One market participant proposed to substitute this case with "suspensions of settlement by CSDs";

b. A trade association proposed to substitute this case by the delisting or exclusion of an ISIN from trading.

171. As regards settlement instructions involving cash settlement outside the securities settlement system operated by the CSD if, on the respective day, the relevant payment system is closed, one financial market infrastructure noted that the application of this scenario is only possible where the CSD knows the payment system e.g. T2 for T2S.

172. The T2S Operator informed that T2S already considers closing days for the relevant currency of the cash leg contained in an instruction to be settled in T2S (EUR and DKK calendars). This circumstance entails that if the intended settlement date (ISD) falls on a closing date, the transaction will not be registered as a settlement fail. They also noted that in the case of a cash leg settling outside T2S, it is the responsibility of the instructing party to use a settlement date aligned with the payment calendar.

173. This comment coincides with others noting that the parties involved should have taken this parameter into account at the time of the transaction and therefore, this exception should be applied restrictively, i.e. only in case of closing due to force majeure or unforeseen circumstances.

174. Finally, one respondent agreeing with the proposal noted that in this case only the cash leg should be exempted from the cash penalty, not the securities leg.

175. Concerning **settlement instructions involving securities under sanctions or anti-money laundering proceedings**, some respondents considered that they can affect a wide range of stakeholders (issuers, CSD participants, intermediaries and trading parties that could be direct/indirect clients of CSD participants) and may be imposed by third-country authorities as well. The SMSG and a market participant considered it necessary to specify which sanctions are referred to and the exact meaning of anti-money laundering proceedings.

176. The T2S Operator and a financial market infrastructure considered that this scenario can be handled with the existing T2S penalty mechanism functionalities[44] via the appeal process and ex-post removal of cash penalties. As a consequence, they did not consider it necessary adding this scenario to the regulatory framework.

177. In relation to **settlement instructions put on hold due to the order issued by a court, the police or similar authority** a few stakeholders noted that sanctions and anti-money laundering proceedings may apply to issuers, to securities issued by those issuers, to CSD participants, intermediaries, and trading parties.

178. Several replies addressed the case of **insolvency proceedings** against a participant (even if this case was not included in the CP, given that is already covered in Level 1). One respondent agreed that cash penalties for late settlement should be suspended if settlement is halted or postponed for reasons relating to insolvency. Other respondents noted that settlement penalties should be waived not only when the insolvent trading party is a direct CSD participant but also when it is a client, or indirect client of a direct CSD participant.

179. Some replies considered it unnecessary to add this exemption to the regulatory framework since this scenario can be handled with the existing T2S penalty mechanism functionalities[45] via the appeal process and ex-post removal of cash penalties.

180. A stakeholder requested further clarification regarding:

a. Penalties to be credited (not debited) to an insolvent direct CSD participant; and

b. Whether this exemption applies to "reorganisation proceedings" including liquidations, removal of banking license or retroactive effect of payment suspensions.

Q2: ESMA would like to ask for the stakeholders' views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions). Please use the table below. Where relevant, additional

[44] The T2S insolvency framework ensures that no new settlement instruction is submitted by the insolvent participant, however instructions already in the system may still trigger cash penalties. These would need to be removed ex post by the CSD. Cash penalties calculated in respect of settlement instructions involving the insolvent participant until that date should be managed separately, i.e., not be included in the aggregated net amounts referred to in Article 17 of the RTS on Settlement Discipline. Cash penalties should not apply to settlement instructions relating to the liquidation of positions of an insolvent participant. In the case where such settlement instructions would be channelled via T2S and incur a cash penalty, it would need to be removed ex post by the CSD via current appeal process.

[45] The T2S insolvency framework ensures that no new settlement instruction is submitted by the insolvent participant, however instructions already in the system may still trigger cash penalties. These would need to be removed ex post by the CSD. Cash penalties calculated in respect of settlement instructions involving the insolvent participant until that date should be managed separately, i.e., not be included in the aggregated net amounts referred to in Article 17 of the RTS on Settlement Discipline. Cash penalties should not apply to settlement instructions relating to the liquidation of positions of an insolvent participant. In the case where such settlement instructions would be channelled via T2S and incur a cash penalty, it would need to be removed ex post by the CSD via current appeal process.

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

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

181. ESMA received limited qualitative feedback regarding the costs and benefits of the proposal and no quantitative evidence at all.

182. Most of the feedback suggests that these exemptions would add legal certainty, improve the allocation of resources, and reduce the number and costs of appeal processes, only where these exemptions can be applied ex-ante.

183. While some respondents considered that the changes would not entail significant costs, a relevant number of stakeholders identified a number of them:

    a. Several trade associations and market participants identified a potential increase in appeals/manual processing if all the proposed scenarios cannot be systemically excluded ex-ante from cash penalty calculations;

    b. A significant number of respondents considered that there would be costs related to the system updates that CSDs would have to introduce to their penalty calculation mechanisms. These changes should be replicated by other market participants who are predicting/monitoring penalties.

184. On a related issue, some responses asked for sufficient lead time to implement and enact any system changes. Some of these respondents requested no less than 24 months after the publication of the Commission Delegated Act in the Official Journal to implement the technical changes. These responses considered that the timing should take into account the points in time of the go-live of the two annual main releases of T2S, if the proposals were finally taken on board.

185. In particular, the T2S Operator and one financial market infrastructure noted that all the cases put forward for exemptions from settlement discipline can be handled with the existing T2S penalty mechanism functionalities and operational framework in place, except for cases related to an ISIN suspended from trading, due to the limitations described above.

Q3: Do you have other suggestions regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions? Please justify your answer and provide examples and data where available.

186. Putting aside a number of replies that cross-referred to the circumstances in which operations are not considered as trading under this section[46], several responses identified the following additional scenarios concerning <u>other possible underlying causes of settlement fails not attributable to the participants.</u>

187. One respondent proposed to add another scenario covering “all situations where a CSD suspends settlement”.

188. Missing master data when the (I)CSD lacks or has not recorded yet the necessary master data for a particular instrument, in such case the (I)CSD will reject instructions on that instrument was raised in the responses.

189. Settlement instructions:

a. A reply mentioned the deletion of instructions by the CSD (only where errors in the original instruction are not attributable to the instructing party). Deletion of settlement instructions by the CSD due to obsolescence was mentioned by another stakeholder;

b. CSD-generated instructions with a back-dated settlement date were identified by several respondents, including Payment Free of Delivery (PFOD) instructions generated by the CSD in the context of credit tax refunds, interest payments or securities cash redemptions. However, some of these responses also acknowledged that these cases are already tackled under the operations not considered as trading;

c. Instructions unilaterally cancelled where the counterparty disagrees or takes no action (and therefore the instruction remains failing for longer periods);

d. Bridge settlement instruction de-selection by ICSDs where the delivery instructions fail because the receiving ICSD lacks acceptance capacity (no unsecured exposure

[46] Several replies alluded to CSD-generated instructions. Where the CSD-generated instruction has a back-dated intended settlement date, the settlement fail is outside of the control of market participants. However, these same respondents acknowledged that the typical examples of these instructions had been included as scenarios deemed operations not considered as trading.

is authorised) or not proposed for settlement to the receiving ICSD due to the lack of Qualified Liquid Resources.

190. One reply considered that matched principal broker entities (usually acting as OTFs) and the settlement facilities acting for MTFs should not be considered as "the participant" under CSDR. Another response also raised the point that CSD participants mostly act on behalf of their underlying clients and are dependent on their behaviour/discipline/business to be able to match and settle transactions in time. Therefore, many fails are not attributable to the CSD participants but to their underlying clients. However, they also concluded that it would not be possible to exempt these cases: first, CSDs would not be able to identify such fail reasons; second, they are so widespread that CSDs would hardly apply any settlement sanctions if such cases were to be exempted.

191. One stakeholder requested a one day "grace period" for transactions in new bonds which are due to settle on that bond's new issue closing date, provided that they are settled by the next CSD business day.

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

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

192. The respondents who made these proposals hardly provided any input as regards their costs and benefits. In broad terms, they considered that these proposals would contribute to the profitable allocation of resources, avoidance of generation and processing of cash penalties which would not incentivise settlement efficiency and achieving greater certainty on the scope of cash penalties. These responses also acknowledged that CSDs should make updates to their penalty calculation mechanisms, that should be replicated by other market participants who predict/monitor penalties. All of them coincided in considering that those would not be major costs.

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

193. Concerning the immunisation principle[47], most respondents did find a risk of breach in all the proposed scenarios. Some respondents considered that uniform application of these proposed causes of settlement fails across CSDs and a unique source of data for their detection are the means to ensure fair application of the scenarios.

194. Several respondents considered that this risk is exacerbated in the case of cross-CSD settlement, due to the risk of inconsistent interpretation/application. At the same time most of these responses considered that those cases would be rare and could be managed by means of bilateral claims.

195. On the contrary, many stakeholders did not identify potential breaches of this principle. Some respondents considered that this risk did not exist in the case of suspension of trading whereas another reply considered that the exceptions regarding settlement instructions involving cash settlement outside the securities settlement system operated by the CSD and settlement instructions involving securities under sanctions or anti-money laundering proceedings did not create that risk.

196. Finally, other respondents questioned the immunisation principle itself:

   a. One respondent considered the immunisation principle does not exist. According to that respondent, cash penalties are assigned at the level of CSD participants and transaction per transaction without any consideration about the link between different transactions;

   b. Another noted that the immunisation principle exists, but it is not an absolute principle. Fairness and improving settlement efficiency should also be considered. Therefore, in case there is a breach of the immunisation principle, it can be managed by means of bilateral claims;

   c. Another respondent considered that the immunisation principle should not exist to incentivise failing counterparties to deliver.

Q6: Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which ones can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs? Please provide details regarding the cost for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

197. In general terms, most respondents, including the CSD community, expressed their preference for exemptions to be applied ex-ante in an automated way. For these

[47] Recital (16) CSDR: Cash penalties imposed on failing participants should, where possible, be credited to the non-failing clients as compensation and should not, in any event, become a source of revenue for the CSD concerned.

respondents, CSD bilateral ex-post appeals should be restricted to penalties that were correctly applied in accordance with the information that was available to the CSD at the time of the calculation.

198. They generally indicated that ex-post exemptions through the appeal mechanism at CSDs are particularly burdensome and may imply greater operational costs than the value of the penalty itself. As a consequence, they should be avoided whenever possible.

199. At the same time, most financial market infrastructures replying to the CP did not identify benefits in changing the (ex-post) way in which these scenarios are currently handled by them. They recommended that each CSD should undertake a cost-benefit analysis to assess the impact of changes in handling of exceptions.

200. This approach was justified by some of them on the limited number of instances in which these exemptions are applied. Other respondents supported this view. One of them noted that CSDs are usually proactive in removing penalties for current exemptions.

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

201. Regarding the **proposed exemptions that cannot be filtered ex-ante**, three cases strongly arise from the responses to the consultation:

   a. Several stakeholders considered that the **exemption due to ISIN suspension** from trading raises concerns under the current CSDs' system capabilities. As previously explained, CSDs currently use the ESMA FIRDS to determine if a financial instrument falls within the scope of cash penalties. For these respondents the relevant ISIN should be removed from FIRDS or flagged as "invalid" to apply such an exemption on an ex-ante basis, which may not be practical. Other solution could be for ESMA to establish and maintain a list of ISIN codes subject to penalties.

   b. Different responses from the CSD community indicated that ex-ante filtering cannot be applied to the item concerning **technical impossibilities at the CSD level** and that, in T2S, they are currently handled ex-post via the appeal process.

   c. A few respondents indicated that when **settlement instructions are put on hold due to measures from courts or administrative bodies**, the participants in the transaction would comply with these measures and put the instruction on hold without informing the CSD of the underlying reason. As a result, it will be necessary to apply the exemption through the appeal process. Other responses also noted that sanctions relating to individual parties should be managed by means of ex-post procedures.

B) Circumstances in which operations are not considered as trading

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

202. Concerning the proposed circumstances that should not be considered as trading, stakeholders indicated that:

a. Free of Payment (FoP) securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral. Whereas most respondents agreed with this proposal if this refers to the specific process involving the ECB and national central banks, many respondents and the ESMA Securities and Markets Stakeholder Group (SMSG) considered that the proposal was not sufficiently clear. In particular, some of them requested clarification on whether tri-party collateral agreements would fall under the scope of this exemption and on whether a FoP collateral transfer to settle an ongoing transaction would be exempted. Other responses noted that, without further specification, the exemption might breach the immunisation principle.

b. In general, most of respondents did not agree to generally exempting the movement of collateral between market participants from the scope of cash penalties. For these respondents, collateral transfer is a risk management function for which it is important that settlement takes place on a timely basis.

c. Some of these respondents recommended going back to the original ECB proposal or requesting further specification from the ECB.

d. Some replies noted technical complexity of the implementation of the proposal mostly based on the lack of harmonisation in the use of different ISO codes covering this type of transaction and the subsequent risk of inconsistent results if this exception is applied (e.g. use of different codes by each leg of the transaction).

e. Market claims, corporate actions on stock such as cash distributions, securities distributions, reorganisations. Respondents were generally supportive of this proposal, considering that market claims are distinct from a transaction in a financial instrument and should not be subject to the penalty regime.

f. Respondents noted that, in the vast majority of cases, market claims are automatically detected and generated by the CSD itself and not the result of a transfer order initiated by the trading parties of the original transaction. A claim will be bilaterally agreed by the parties to the underlying transaction, in the event that it is not automatically generated by the CSD.

g. In relation to corporate actions, the settlement instruction CORP is already in place in T2S. Market claims also received wide support, including from the CSD community, as the respondents noted that these instructions (CLAI) are already exempted from cash penalties under the ECSDA CSDR Penalties Framework[48].

203. However, some comments considered that this exception could breach the immunisation principle:

a. Several responses identified market claims as an example where the immunisation principle could be breached if market participants trade in anticipation of a dividend or corporate action payment date, as a fail to deliver would trigger a "chain of fails" and, in case of late delivery, the person who committed to deliver would become a net payer.

b. According to one trade association, where a CCP has a failed market claim pending to settle against a normal trade, the absence of a penalty on the former would leave the CCP short and therefore in imbalance.

204. Stakeholders requested further clarifications:

a. Respondents had varying interpretations regarding whether transformations fell within the scope of market claims.

b. A market participant noted that it is unclear whether the proposal covers initial corporate actions, automated market claims and secondary market claims.

205. As regards the process of the technical creation of securities, respondents were generally supportive of this exemption. However, a number of replies noted the practical implications of this proposal:

a. The process for technical creation of securities is not harmonised across CSDs.

b. There is a need to harmonise the use of transaction codes to define which ones would benefit from the exemption. In particular, the T2S Operator noted that the ISO transaction code ISSU is not harmonised across CSDs and market participants. Therefore, its implementation may provide inconsistent results in the absence of harmonisation and control. Furthermore, such technical transactions hardly fail when submitted to settlement.

c. Other stakeholders asked whether the process of technical creation of securities included the creation/redemption of ETFs between the issuer and the CSD.

[48] 2021_10_05_ECSDA_CSDR_Penalties_Framework.pdf

d. Moreover, the process of technical creation of securities was mentioned by a number of respondents as a possible breach of the immunisation principle from different angles:

    i. The possibility of a “chain of fails” when parties are required to re-deliver securities that they should have received from these processes, whereby they would become net payers of cash penalties in case the technical creation of securities is exempted.

    ii. The possibility of a “chain of fails” is increased when several CSDs are involved. The misalignment of settlement deadlines in case of issuance of US securities to be delivered in the EU was mentioned by two respondents.

e. Some replies proposed that all primary or secondary market transactions in a new bond which are due to settle on that bond’s new issue closing date should benefit from a one-day ‘grace period’. Another response considered that these cases would be rare, though.

f. Creation and redemption of fund units on the primary market (i.e. the technical creation and redemption of fund units). Respondents were generally supportive of this exemption.

g. For ETFs in particular, several responses distinguished between:

    i. The primary market transaction (i.e. the transfer between the transfer agent and the authorised participant), that should be in the scope of cash penalties. One respondent suggested including transfers of securities to one or more distribution accounts.

    ii. The technical creation of ETFs shares (i.e. the shares issued or redeemed on the fund issuance account of the transfer agent at the CSD/depository) should be out of scope of the cash penalty mechanism. For these responses, this is already included under the item “technical creation of securities”.

    The practical implementation of this exception was analysed by the T2S Operator and a financial market infrastructure, noting that the usage of the ISO transaction codes ‘SUBS’ and ‘REDM’ is not fully standardised across CSDs and their participants. Additionally, these responses noted that the asset type should also be considered to identify the exact operation type and exclude ETFs. This additional filter would render the implementation of such exemption even more complex.

h. Realignment operations. Respondents agreed that realignments within the context of T2S should be specifically left out of scope. It is worth noting that some stakeholders considered this exception as too vague and requested further specification in the final technical advice. One response recommended aligning the definition of "realignment operations" with that of T2S and referring to "technical T2S realignments" to prevent a breach of the immunisation principle.

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

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

206. Several responses considered that the main impacts of the proposals would be:

a. Efficiency: Avoids the generation and processing of cash penalties, which are ineffective at incentivising improved settlement efficiency.

b. Clarity: Provides greater certainty on the scope of application of cash penalties.

c. Transparency: Calculation of penalties will become simpler and more comprehensible.

207. The main cost identified by these responses was the potential increase in appeals and the one-off costs for CSDs to deploy the system changes required. One response noted that, as opposed to the causes of settlement fails not attributable to the participants, the number of circumstances not considered as trading would be much higher.

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

208. As regards potential additional scenarios that should not be considered as trading, one response warned against a too broad interpretation of these exemptions. In their view, this could have an overall negative impact on settlement efficiency levels and undermine the immunisation principle. However, other respondents suggested adding more scenarios under this exception.

209. The main bulk of these responses considered that the **transfer of securities from one CSD account to another CSD account that does not imply a change of ownership** should be deemed equivalent to T2S realignments. These responses considered that the operations to which this exemption should be extended are currently covered under the ISO codes No Change of Beneficial Ownership (NCBO), Portfolio Transfer (PORT), External Account Transfer (OWNE), Internal Account Transfers (OWNI) and Realignments (REAL). Another reply referred to technical account transfers between two separate accounts of the same CSD participant. This point was supported by one financial market infrastructure.

210. It is worth noting that some other participants were against such extension, considering that, as opposed to T2S realignments which are already operational, participants realignments would be costly to implement and did not consider them as a priority.

211. Apart from that, there were requests for exempting **share registration bookings**, which were considered particularly relevant for the German market. According to these replies, regularly failing FoP share registration orders lead to a high number of settlement fails.

212. Some responses disagreed with ESMA's preliminary view regarding the inclusion of failed deliveries on a market sale transaction caused by the delay in issuing the instrument on the primary market or restrictions during a corporate action. For these respondents the settlement failure is caused by slow reconciliation processes or delays from Participant Paying Agents, not the fault of transaction parties. On the contrary, one stakeholder explicitly supported their inclusion in the MBI and the cash penalties regime.

213. Other proposals coming from the responses to the CP included those related to testamentary transactions or securities movements at CSDs reflecting the transfers of securities between a depository receipt (DR) issuer and an investor as part of the process of converting underlying securities into DRs or DRs into the underlying securities.

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

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

214. A limited number of responses was received. For these respondents, the main impacts of the additional proposals would be:

   a. Efficiency: Avoids the generation and processing of cash penalties, which are ineffective at incentivising improved settlement efficiency.

   b. Clarity: Provides greater certainty on the scope of application of cash penalties.

215. The main cost identified by these responses was the one-off costs for CSDs to deploy the system changes required.

216. One stakeholder proposing that the only types of operations that should not be considered as trading are (i) technical operations carried out by a CSD, and (ii) administrative transfers. Whereas the identifiable costs for the first proposal were considered as limited, this respondent acknowledged that the second proposal could entail higher costs, depending on the information transmission mechanism.

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

217. The responses received were split as regards any potential breach of the immunisation principle from the proposed operations not considered as trading. Six replies considered that the proposed cases did not breach the immunisation principle. One of them considered that they would entail very few, if any, breaches of the immunisation principle, provided that the application of the exemption is conditional on the submission of identical transaction codes by both parties.

218. However, several replies expressed different concerns as regards this proposal already described in the previous paragraphs. One respondent recommended taking a restrictive approach and narrowing down the definitions as to the different cases that would not be considered as trading.

219. Similarly to the cases not attributable to market participants, stakeholders reiterated points already made as regards the immunisation principle:

a. There is a risk that the immunisation principle will be breached if exemptions are not evenly applied to all settlement instructions.

b. The immunisation principle does not exist because settlement fails are treated independently and are not subject to the same calculation methodology.

c. The immunisation principle should not exist.

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

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

220. Stakeholders discussed whether the proposed exemptions could break the immunization principle, generally agreeing that most of the exemptions could be filtered out ex-ante without violating the principle.

221. Several respondents emphasized that the exemptions should be applied through automated systems to avoid the complications of manual interventions, which would lead to inefficiencies. For instance, one stakeholder supported ex-ante filtering for transactions involving central banks but highlighted that filtering based on specific transaction types could be more complex, especially for certain financial instruments like ETFs. Another respondent expressed concerns about using the Transaction Type code as a criterion for filtering out transactions, noting that the lack of harmonization across CSDs and considerations on making the type of transaction a matching criterion could trigger several issues.

222. Various stakeholders underscored the importance of identifying exemptions clearly at the CSD level to avoid manual appeals. They suggested that ex-ante filtering, when applied correctly, would lead to operational efficiency and cost savings. One respondent specifically recommended using transaction recipient information, such as Central Bank status, as a criterion for exemptions, and highlighted the potential for ESMA to maintain an ISINs list to help identify exempt financial instruments. In conclusion, according to stakeholders, with the current proposed exemption, operations (for example a portfolio transfer) that are not a subscription or a redemption would be penalized should they fail to settle.

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

223. Most of the responses received reiterated that automated ex-ante filtering would lead to clarity, long-term greater operational efficiency and cost savings, avoiding the complications and inefficiencies derived from the administrative burden from manual interventions. However, they did not specify any potential related costs.

224. Some responses considered that ex-ante filtering of administrative operations would be costly, in particular for some CSDs. These costs include significant investment in system upgrades, particularly to accommodate the SWIFT qualifiers and transaction code adaptations required for consistent filtering. Some stakeholders noted that development costs could increase for institutions that need to adjust their processes to provide the correct transaction types.

225. In line with the questions in the CP, there was broad support for using the transaction type code as the best way to identify operations not considered as trading.

226. Support for the transaction type as method to ex-ante filter 'non-trading' operations was not unanimous, though. Some stakeholders expressed strong concerns regarding the practical implementation of ex-ante filtering based on the transaction type. For them, the primary consideration is whether the type of operation proposed to be exempted:

   a. can be identified unequivocally; and

   b. can be filtered ex-ante by the penalty mechanism (i.e. built into the design), in order to be operationally manageable given the potential volumes of instructions to exempt and to avoid any manual intervention.

227. These responses noted that each settlement instruction must be filled in with a securities transaction type code (ISO transaction code), to identify the type of transaction/operation it belongs to, which is not a matching criterion. However, the use of ISO transaction codes is not harmonized, and some CSDs and their participants merely rely on ISO description guidelines[49]. Therefore, the same ISO transaction code may be accepted, conditionally accepted, or rejected depending on the CSD.

228. Another group of respondents warned against using the transaction code for these purposes due to a number of reasons:

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[49] The **ISO transaction code** and **ISO description guidelines** serve different purposes within the financial messaging standards:

1. **ISO Transaction Code** is a specific code used to identify and categorize different types of financial transactions within a messaging system. For example, in the ISO 8583 standard for card-based transactions, transaction codes like "0100" for authorization and "0200" for balance inquiry are used to specify the type of transaction being processed.
2. **ISO Description Guidelines** provide detailed descriptions and specifications for the various data elements, message formats, and codes used in the ISO standards. They help ensure that all parties involved in the transaction understand the structure and content of the messages being exchanged. For example, the ISO 20022 guidelines offer comprehensive descriptions of message types, data elements, and their usage in financial transactions.

a. The transaction type data is provided by the professional client and conveyed through the chain; it cannot be changed without starting the process anew, leading to rigidity.

b. When unitary transactions with different transaction types are netted into a single one, there would be a need to separate the "in" and "out" transactions, adding further complexity.

c. That complexity would be further increased if it were necessary to consider the type of financial instrument (which would be needed to filter ETF-related cases).

229. Along the same line, some responses specifically recommended ex-ante filtering where the recipient of the transfer of securities is a Central Bank. Other respondents proposed ESMA to maintain an ISINs list to help identify “in-scope” financial instruments for the exemption related to the creation and redemption of fund units.

230. In this context, responses provided different views on whether the transaction code should become a matching field.

231. Certain respondents proposed that it should be established as a matching criterion, meaning that both parties involved in the transaction must clearly indicate it in their settlement instructions. These responses underlined that the responsibility for using the correct trade types does not solely rest on the parties directly involved in the transaction but also extends equally to any intermediaries, such as custodians or agents, that may be involved in the process.

232. In contrast, a relevant number of responses warned against making the transaction code a matching criterion, since it could lead to a high number of matching fails. As noted by one response, two instructions with different transaction codes can match and settle. If the transaction code becomes a matching field, it would no longer be the case, increasing the number of settlement fails.

233. For these stakeholders, further harmonisation/market practices and a detailed technical/functional assessment, considering also potential undesirable collateral effects on settlement efficiency, would be needed before making this field a matching criterion and a subsequent T2S change request.

234. In the absence of those steps, different CSDs could apply different exemptions.

235. Different stakeholders emphasised that the only practicable means to achieve systematic ex-ante filtering from the settlement discipline regime would be to require both participants' settlement instructions to include identical transaction type codes. One market player elaborated about the advantages of this approach: it would have no impact on the matching mechanism for settlement and would not lead to an increase in settlement fails. Another response considered that this approach would also incentivise the use of the transaction type codes more consistently.

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

236. When asked about the transaction types based on the codes allowed by T2S (or other codes such as ISO transaction codes) that should be exempted from the settlement discipline measures, the codes more frequently mentioned were CLAI, COLI, COLO, CONV, CORP, ISSU, OWNE, OWNI, PLAC, PORT, REAL, REDM, RELE, SUBS. It is worth noting that other ISO transaction codes received support from the industry to be used for this purpose.

237. A stakeholder recommended to exempt newly issued securities in the case of IPOs from CSDR penalties, ideally allowing for a one-week grace period for secondary trading.

8.2 Annex II – EC request regarding Technical Advice on possible delegated act specifying the scope of operations and transactions subject to the settlement discipline regime

REQUEST TO THE EUROPEAN SECURITIES AND MARKETS AUTHORITY (ESMA) FOR TECHNICAL ADVICE ON POSSIBLE DELEGATED ACT SPECIFYING THE SCOPE OF OPERATIONS AND TRANSACTIONS SUBJECT TO THE SETTLEMENT DISCIPLINE REGIME *(Ref: Ares(2023)8061362 – 27/11/2023)*

Commission Delegated Regulation (EU) 2018/1229

With this mandate, the European Commission seeks ESMA's technical advice on a possible new delegated act supplementing Regulation (EU) No 909/2014 (Central Securities Depositories Regulation (CSDR))[50] specifying further the scope of operations and transactions subject to the settlement discipline regime. This delegated act should be adopted in accordance with Article 290 of the Treaty on the Functioning of the European Union (TFEU). The Commission reserves the right to revise and/or supplement this mandate. The technical advice received on the basis of this mandate should not prejudge the Commission's final decision. The provisional mandate reflects the revision of the CSDR, as agreed by the European Parliament and the Council on 27 June 2023. In addition, the mandate should take account of the Communication from the Commission to the European Parliament and the Council – Implementation of Article 290 of the Treaty on the Functioning of the European Union (the "**290 Communication**")[51], and the

[50] 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.
[51] Communication of 9.12.2009. COM (2009) 673 final.

Framework Agreement on Relations between the European Parliament and the European Commission (the "**Framework Agreement**")[52].

According to the agreed draft text of Article 7(9) of the revised CSDR, the Commission will be empowered to adopt delegated acts in accordance with Article 67 CSDR to specify the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction (Article 7(3), point (a)) and the circumstances in which operations are not considered as trading (Article 7(3), point (b)). Specific provisions in the CSDR text, namely Article 7(3) and Article 7a(7)(a), exempt these operations and transactions from the scope of the cash penalties and mandatory buy-ins, respectively. The experience gathered by the European Commission and the relevant European and national competent authorities in operating the settlement discipline regime indicate that exemptions from the settlement discipline regime require further operationalisation and clarification in order to allow for an efficient and effective operation of the settlement system by the central securities depositories. The European Parliament and the Council shall be duly informed about this mandate.

In accordance with Declaration 39 on Article 290 TFEU, annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007, and in accordance with the established practice within the European Securities Committee[53], the Commission will continue, as appropriate, to consult experts appointed by the Member States in the preparation of possible delegated acts in the financial services area. In accordance with point 15 of the Framework Agreement, the Commission will provide full information and documentation on its meetings with experts appointed by the Member States within the framework of its work on the preparation and implementation of Union legislation, including soft law and delegated acts. Upon request by the Parliament, the Commission may also invite Parliament's experts to attend those meetings. The powers of the Commission to adopt delegated acts are subject to Article 67 CSDR. As soon as the Commission adopts a proposed delegated act, the Commission will notify it simultaneously to the European Parliament and the Council.

Context

Scope

The Central Securities Depositories Regulation (CSDR) includes a set of measures to prevent and address failures in the settlement of securities transactions (settlement fails), commonly referred to as settlement discipline measures. These measures consist of reporting requirements, cash penalties for central securities depositories' (CSD) participants in case of settlement fails, and mandatory buy-ins where a CSD participant fails to deliver the security within a fixed extension period. Cash penalties are applied to all failing settlement instructions

[52] OJ L 304, 20.11.2010, p. 47.
[53] Commission's Decision of 6.6.2001 establishing the European Securities Committee, OJ L 191, 17.7.2001, p.

in EU CSDs since 1 February 2022, while the implementation of the mandatory buy-in process has been temporarily suspended.[54]

Many and diverse transactions and operations are undertaken in EU capital markets. Not all of these transactions and operations should necessarily be subject to the provisions of the settlement regime. Simultaneously, improving the functioning of, and further integrating the post-trade landscape in, the EU is one of the objectives of the Capital Markets Union[55]. Therefore, an effective, efficient, and proportionate settlement discipline regime should discourage failed settlement instructions. However, this regime should not cover the cases where the settlement discipline measures would not be practicable or could lead to detrimental consequences for the market. In addition, settlement instructions which fail due to reasons not attributable to the participants in the transaction or operation should not be covered either.

In March 2022, the Commission proposed a review[56] of CSDR, including of the provisions related to settlement discipline. The objective was to ensure that the Regulation remains proportionate, effective and efficient. The targeted public consultation supporting the review as well as the subsequent opinion[57] of the European Central Bank (ECB) regarding the Commission's proposal indicated that the settlement discipline regime requires further specification in order to make the rules operational and better tailored to the diversity of market operations and transactions that can potentially be subject to the regime.

On 23 June 2023, the Council and Parliament reached a provisional agreement to update the rules on central security depositories (CSDs)[58]. The new Regulation will contain measures to improve settlement efficiency by amending certain elements of the settlement discipline regime, including by reducing compliance costs and regulatory burdens. Furthermore, to ensure a smooth and orderly functioning of the financial markets concerned, the settlement discipline regime should not automatically penalise every individual settlement fail regardless of the context, or the parties involved.

As such, Article 7(3) (Measures to address settlement fails), as amended by the CSDR review, will specify that settlement fails the underlying cause of which is not attributable to the participants in the transactions or operation that are not considered as trading are not subject to the settlement penalty mechanism (Article 7(3), points (a) and (b)). In addition, Article 7a(7), point (a) (Mandatory buy-in process), as introduced by the CSDR review, exempts the settlement fails stemming from operations and transactions listed in Article 7(3) from the mandatory buy-in process. Lastly, Article 7(9), as amended by the CSDR review will empower the Commission to adopt delegated acts in accordance with Article 67 to supplement the CSDR

[54] Commission Delegated Regulation (EU) 2022/1930 of 6 July 2022 amending the regulatory technical standards laid down in Delegated Regulation (EU) 2018/1229 as regards the date of application of the provisions related to the buy-in regime
[55] Communication from the Commission, A Capital Markets Union for people and businesses – New Action Plan, COM (2020) 590 final
[56] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 909/2014 as regards settlement discipline, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories, COM (2022) 120, Brussels, 16.03.2022.
[57] Opinion of the European Central Bank of 28 July 2022 on a proposal for a regulation amending the Central Securities Depositories Regulation, CON/2022/25, Official Journal of the European Union C367/3, 26.09.2022
[58] "Central Securities Depositories: Council and Parliament reach agreement", Council of the EU, Press Release, 27 June 2023

by specifying the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction under paragraph Article 7(3), point (a), and the circumstances in which operations are not considered as trading under Article 7(3), point (b).

These provisions require further specification in order to ensure a proportionate, effective and efficient implementation of the settlement discipline regime. The evidence gathered during the course of the CSDR review indicates that CSDs might not be operationally able to identify settlement instructions that are to be excluded from the scope of the regime. For instance, the ECB suggests in its opinion to clarify the scope of transactions that do not involve "two trading parties". The ECB argues that free-of-payment securities transfers to accounts at CSDs in the context of the (de)mobilisation of collateral, irrespective of whether those transfers are between private parties or between members of the ESCB and their counterparties, should be excluded from the settlement discipline regime[59]. Furthermore, the targeted consultation supporting the CSDR review[60] indicated that a number of other transactions may potentially be out of scope of the settlement discipline regime. For instance, some stakeholders argued that portfolio transfers where the buyer and seller are the same should be exempted, while others believed that subjecting primary market trades to the buy-in would be disruptive to those markets.

In light of the above, the Commission asks ESMA to provide a technical advice on a Commission Delegated Act specifying (i) the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction and (ii) the circumstances in which operations are not to be considered as trading. In its advice, ESMA should ensure that its approach, while specifying the exemptions under Article 7(3), is effective and proportionate. Specifically, ESMA should consider addressing market behaviour that leads to settlement inefficiencies, but without automatically penalising every individual settlement fail regardless of the context and parties involved. The advice should allow for easy identification of transactions and operations that are out of scope of the settlement discipline regime and hence reduce the administrative burden and compliance costs for CSDs. It should, however, not compromise the overall objective of the CSDR, namely, to incentivise the settlement of transactions on the intended settlement date with a minimum exposure of its participants to counterparty and liquidity risks and a low rate of settlement fails[61].

Principles that ESMA should take into account

On the working approach, ESMA is invited to take account of the following principles:

- The principle of proportionality: the technical advice should not go beyond what is necessary to achieve the objective of the Regulation. It should be simple and limit to the largest extent

[59] Paragraph 1.2, Opinion of the European Central Bank of 28 July 2022 on a proposal for a regulation amending the Central Securities Depositories Regulation, CON/2022/25, Official Journal of the European Union C367/3, 26.09.2022.
[60] "Summary report of the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories, 8 December 2020 – 2 February 2021". Out of the 58 respondents to questions relating to requirements applying to the settlement of financial instruments, 51 replied that clarifications are necessary. These include public authorities, CSDs, their participants, clients of the participants and associations. See p.38 – p.43.
[61] Art. 6(3) CSDR

possible financial, administrative, or procedural burdens for counterparties and financial infrastructure providers, in particular CSDs.

- When preparing its advice, ESMA should seek coherence within the regulatory framework of the Union.

- In accordance with the Regulation of the European Parliament and the Council establishing a European Securities and Markets Authority (the "ESMA Regulation") , ESMA should not feel confined in its reflection to elements that it considers should be addressed by the amendment to the delegated act but, if it finds it appropriate, it may indicate guidelines and recommendations which, in its view, could be appropriate to accompany the delegated act to better ensure its effectiveness.

- ESMA will determine its own working methods depending on the content of the provisions being dealt with. Nevertheless, horizontal questions should be dealt with in such a way as to ensure coherence between different standards of work being carried out by the various expert groups.

- In accordance with the ESMA Regulation, ESMA should, where relevant, involve the European Banking Authority and the European System of Central Banks in order to ensure cross-sectoral consistency. It should also cooperate, where relevant, with the European Systemic Risk Board on any issues related to systemic risk.

- In accordance with the ESMA Regulation, ESMA is invited to widely consult market participants in an open and transparent manner. ESMA should provide a detailed feedback statement on the consultation, specifying when consultations took place, how many responses were received and from whom, as well as the main arguments for and against the issues raised. This feedback statement should be annexed to its technical advice. The technical advice should justify ESMA's choices vis-à-vis the main arguments raised during the consultation.

- ESMA is invited to justify its advice by providing a quantitative and qualitative cost-benefit analysis of all the options considered and proposed. ESMA should provide the Commission with a description of the problem, the objectives of the technical advice, possible options for consideration and a comparison of the main arguments for and against the considered options. The cost-benefit analysis should justify ESMA's choices vis-à-vis the main considered options.

- ESMA's technical advice should not take the form of a legal text. However, ESMA should provide the Commission with a clear and structured ("articulated") text, accompanied by sufficient and detailed explanations. Furthermore, the technical advice should be presented in an easily understandable language respecting current terminology in the Union.

- ESMA should provide comprehensive technical analysis on the subject matters described in section 3 below, where these are covered by the delegated powers included in:

o the relevant provision of the Regulation as amended;

o the corresponding recitals; or

o the relevant Commission's request included in this mandate.

- ESMA should address to the Commission any question to clarify the text of the Regulation or the relevant Regulatory Technical Standard it considers of relevance to the preparation of its technical advice.

Procedure

The Commission is requesting ESMA's technical advice in view of the preparation of a Commission Delegated Act specifying (i) the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction and (ii) the circumstances in which operations are not to be considered as trading.

The mandate takes into account the CSDR (Articles 7(9) and 67), the ESMA Regulation, the Communication on the implementation of Article 290 of the Treaty on the Functioning of the European Union (TFEU) and the Framework Agreement on relations between the European Parliament and the European Commission .

The Commission reserves the right to revise and/or supplement this mandate. The technical advice received on the basis of this mandate will not prejudge the Commission's final decision.

In accordance with established practice, the Commission may continue to consult experts appointed by the Member States in the preparation of the amendment to the delegated act.

The Commission shall duly inform the European Parliament and the Council about this mandate. As soon as the Commission adopts the delegated act, it will notify it simultaneously to the European Parliament and the Council.

ESMA is invited to provide technical advice on the following issues.

ESMA is invited to provide technical advice to assist the Commission in preparing a Commission Delegated Act to specify (i) the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions and (ii) the circumstances in which operations are not considered as trading, both in accordance with Article 7(3), point (a), and (9) as amended by the CSDR review. In particular, in order to ensure a proportionate, effective and efficient implementation of the settlement discipline regime the advice should clearly define criteria, i.e. the type, circumstances and parties involved to transactions and operations, which do not justify inclusion of the particular transaction and/ or operation in the scope of the settlement discipline regime. In its reflections, ESMA should also consider whether the specific conditions for exemptions of a particular transactions and/ or operation equally justify exemption from both the cash penalties regime as well as the mandatory buy-in process.

The technical advice should contribute to an effective, efficient, and seamless operation of the settlement discipline regime. However, it should not impede the rigorous application of the settlement discipline regime by expanding excessively and unjustifiably the scope of its exemptions. In its advice ESMA, where appropriate, should take account of the different types of securities, transactions and operations, parties involved and the objective of the transactions and operations or any other criteria it deems necessary. The proposed technical advice should not lead to further fragmentation of the single market for capital, while the identification of the relevant transactions and operations should lend itself to automation by CSDs in order to ensure the seamless and cost-effective operation of post-trade infrastructures. Lastly, the advice provided should reduce compliance costs and regulatory burden put on CSDs and participants to the securities settlement system, without jeopardizing financial stability and resilience of the EU capital markets.

Indicative timetable

This mandate takes into consideration that ESMA requires sufficient time to prepare its technical advice and that the Commission needs to adopt the amended delegated act according to Article 290 TFEU. The powers of the Commission to adopt delegated acts are subject to Article 67 CSDR that allows the European Parliament and the Council to object to a delegated act within a period of 3 months, extendible by 3 further months at the initiative of the European Parliament or of the Council. The delegated act will only enter into force if neither European Parliament nor the Council have objected on expiry of that period or if both institutions have informed the Commission of their intention not to raise objections.

It is of outmost importance to start the work on this issue as soon as possible. The deadline set to ESMA to deliver the technical advice is therefore 31 December 2024.

8.3 Annex III – SMSG advice on the exceptions to the penalty regime

238. In order to incentivise the settlement of transactions in financial instruments by their intended settlement date, CSDR introduced settlement discipline measures in its article 7, in the form of (i) cash penalties for market participants that cause settlement fails and (ii) a mandatory buy-in regime to force the settlement of transactions still failing after a determined extension period.

239. CSDR Refit significantly detailed the specifications related to the disciplinary measures, while explicitly differentiating the buy-in regime from the penalty regime through a dedicated article 7a.

The importance of differentiating the scope of exceptions from the penalty and from the buy-in regimes

240. The SMSG believes that the differentiation of the penalty and of the buy-in regime was of the utmost importance to optimize the effect of the settlement discipline measures while avoiding unintended consequences on the functioning of markets. This differentiation should be completed through the specification of the scopes of exemptions.

241. The SMSG suggests that also under article 7.3. (b) CSDR the ESMA's proposal to exclude free-of-payment (FoP) securities transfers to securities accounts at CSD 's in the context of the (de)mobilisation of collateral (cf. ESMA consultation number 19 (a)) should be further clarified. It is not clear which market operations should be considered as FoP transactions in the case of (de)mobilisation of collateral. If FoP collateral transfer transactions are excluded, there could be a fundamental risk that, for example, in cases of late recalling of a securities lending transaction due to a sale, the cash claiming process vis-à-vis the lending counterparty could no longer be carried out. Both lending instructions and transactions for bilateral collateralization are mainly transmitted as FoP transactions via SWIFT. Exempting FoP security collateral transfers may sometimes break the immunisation principle. Therefore, the SMSG encourages ESMA to further clarify what is meant by a free-of-payment security transfer to securities accounts at CSD's in the contact of the (de)mobilisation of collateral.

242. Under the article 7.3. as amended by CSDR Refit, the penalty regime does not apply to (a) settlement fails the underlying cause of which is not attributable to the participants in the transaction, (b) operations that are not considered as trading, (c) transactions where the failing participant is a CCP, except for transactions entered into by a CCP where it does not interpose itself between the counterparties; or (d) transactions where insolvency proceedings are opened against the failing participant.

243. Article 7a.7. introduced by CSDR Refit defines the exemption scope for the buy-in regime as (a) transactions exempted from the penalty regime under article 7.3.; (b) securities financing transactions; (c) other types of transactions that render the buy-in process unnecessary; and (d) transactions relating to the buy-in procedures that central counterparty in a Member State that provides clearing services for shares are required to have in place under Article 15 of Regulation (EU) No 236/2012.

244. The mandate given to ESMA by Article 7a.15. (d) introduced by the Refit CSDR to clarify the scope of "other types of transactions that render the redemption process unnecessary" explicitly mentions "financial guarantee agreements or transactions that include netting and termination provisions".

245. When considering this mandate, the SMSG invites ESMA to adopt a carefully defined approach to exemptions from the buy-in process in order to cover all types of transactions for which buy-ins would not be helpful. For example, in the case of a

portfolio transfer between custodians on behalf of the same asset owner, while the opportunity of applying penalties on fails may be discussed, the SMSG is of the opinion that buy-ins would be unnecessary. The SMSG proposes starting with a clear, fixed list of exempt transactions which is reviewed on a regular basis to ensure that it remains relevant and can evolve to include new types of transactions if and when necessary. Against this background, the SMSG considers that a dedicated impact assessment could be conducted to evaluate the potential effects of these exemptions on market quality indicators (e.g., liquidity, spreads, and costs), including for retail investors.

The need to consider costs and difficulties of implementation upstream

246. The SMSG notes and fully supports the reiterated requirement by ESMA, across the consultation paper, for indications of "costs and benefits" relating to the implementation of the contemplated exemptions. Opting for solutions with a suboptimal cost / benefit ratio would translate into unnecessary increase in the operating costs of the intermediaries involved in settlement operations, ultimately impacting investors in European assets and affecting the attractiveness of EU financial markets.

247. Limiting the implementation costs of the penalty regime and of its exemptions is all the more important as the intermediaries involved in settlement activities are set to be deeply impacted, and their project resources to be strained, by the projects required for the envisaged shortening of the settlement cycle in the EU ("T+1 transition").

248. With this in mind, the SMSG calls ESMA to carefully weigh the costs linked to alternative solutions, specifically in the choice between ex-ante application of the exemptions and ex-post correction, and between automated processes and appeal procedures. A dedicated impact assessment study, based on aggregated expected volumes, may be worthwhile in this domain. The SMSG also believes that a transparent and predictable process is expected to foster market integrity. In this respect, if exemptions are handled more predictably (ex-ante), this might increase confidence among investors.

249. By the same token, ESMA should take into account from inception the way to provide market participants with those instruments features that may trigger the application of exemptions to the penalty regime. This would notably be the case for (i) securities under sanctions or anti-money laundering proceedings or (ii) securities suspended from trading or from settlement, where ESMA needs to consider the practical implications related to the implementation of the regulation.

250. For example, to minimize the compliance costs referred to in Q2 of the Consultation Paper, it would be useful to specify which sanctions are referred to and the exact meaning of anti-money laundering proceedings. The SMSG recommends envisaging FIRDS as a golden source for that purpose, to avoid differences in interpretation from market participants about the scope of concerned instruments.

<u>The need to anticipate on the possible impact of a transition to T+1 on the quality of settlement in the EU</u>

251. The SMSG notes that, because of the complexity of EU post-trading landscape (primarily linked to the fragmentation of infrastructures, the multiplicity of currencies involved, the use of batches rather than continuous processes in the settlement operations, etc.), the move to T+1 in the EU could result in a temporary increase in settlement fails.

252. This effect could be particularly pronounced for certain classes of instruments that present specific features, notably bonds and ETFs.

253. The bond market relies on the intervention of market makers, who take risks to offer the immediacy required by investors for the execution of their orders. Market makers do not always trade on the ground of their inventory. When a transaction leads to a net short position, the market maker has to borrow the bond in order to settle the transaction. Despite the 2014 move to T+2 for cash transactions, the EU overnight borrowing market remains underdeveloped. Market practice and availability of overnight borrowing could take some time to adjust, leading to more frequent fails in that period. A temporary suspension in cash penalties might be considered to avoid a negative impact on the willingness of market makers to provide liquidity. However, such measures should be carefully scrutinized and closely monitored to make sure they do not undermine market efficiency and integrity.

254. From an EU ETF standpoint, the situation is even more complex. On the one hand, SMSG members note that the current global misalignment may generate fails given that for US underlying instruments (primary) trades settle T+1 while fund unit (secondary) trades in the EU settle T+2 or later. In addition, the current misalignment appears to impact the ETF market itself, with wider spreads, ETFs trading at premiums to their fair value, volumes being determined by the day of the week, different prices for T+1 vs T+2 settling in the same ETF, and potential underperformance in UCITS (not just ETFs) due to the funding gap caused by misaligned settlement. An exacerbation of these trends can be anticipated as more and more countries migrate to T+1. From this standpoint, when ETF primary and secondary settlement cycles do align on T+1 across the board following a European migration, settlement quality could be expected to improve.

255. At the same time, and similarly to bonds, the ETFs market largely relies on the intervention of market makers, with the specificity that some market makers ("Authorised Participants") can ask for the creation or redemption of ETF shares to the issuer, when they are short or long on such shares. The creation/redemption process is made all the more burdensome as (i) the process may depend on the ability to transact on securities located in different time zones and as (ii) many ETFs are issued with different CSDs, so APs have to manage their positions across multiple CSDs using transfers between CSDs. This already explains the lower timely settlement rate

observed for European ETFs relative to other assets. Without additional measures to improve settlement efficiency, moving to T+1 could make the process more difficult to operate. The SMSG calls on ESMA to ensure that these operational challenges do not harm investors and market integrity.

256. The SMSG encourages ESMA to contribute to the acknowledgement of these specific issues through its participation to the work surrounding the envisaged transition to T+1 and its planned consultation on other measures to improve settlement efficiency. Potential attenuation measures (e.g. the ability to temporarily suspend the penalty mechanism, at least for the most exposed classes of and to avoid making significant changes to current penalty rates or methodology) will need to be assessed well ahead of the transition to T+1.

257. The SMSG also emphasizes that individual investors – who often use ETFs as an accessible and lower-cost investment vehicle – should be shielded from any negative impacts arising during the transition (e.g., increased costs, widened spreads, or liquidity shortages).

8.4 Annex IV – Cost-benefit analysis

1. As per the European Commission's request, ESMA should "justify its advice by providing a quantitative and qualitative cost-benefit analysis of all the options considered and proposed. ESMA should provide the Commission with a description of the problem, the objectives of the technical advice, possible options for consideration and a comparison of the main arguments for and against the considered options. The cost-benefit analysis should justify ESMA's choices vis-à-vis the main considered options".

2. In this section, ESMA presents the cost-benefit analysis covering the main policy options considered. The results are based on ESMA's internal analysis and direct input from stakeholders in the consultation on the Technical Advice on the scope of the CSDR settlement discipline. However, it is worth noting that the responses to the consultation did not provide any quantitative evidence to support their comments.

3. In line with the technical advice, the costs and benefits regarding the policy options taken in relation to the identification of the causes of settlement fails not attributable to the participants and the operations not considered as trading have been separated from their practical implementation.

8.4.1 Underlying causes of settlement fails that are considered as not attributable to the participants in the transactions

Problem identification

4. One of the changes brought by CSDR Refit refers to the need for further specification of the circumstances in which cash penalties are applicable in order to make the settlement discipline rules operational and better tailored to the diversity of market operations and transactions that can potentially be subject to the regime. As such, it becomes necessary to clarify the situations where settlement cannot be performed for underlying causes that are not attributable to the participants of transactions.

Policy objectives

5. There are two main objectives to be considered:

   - firstly, reducing the administrative burden and compliance costs of CSDs and market participants;

   - secondly, ensuring a proportionate, effective and efficient implementation of the settlement discipline regime.

Baseline scenario

6. In addition to situations where insolvency proceedings are opened against the failing participant in accordance with Article 7(12) of CSDR, the CSDR Q&As (ESMA70-156-4448) cover four cases where cash penalties should not be applied where settlement cannot be performed for reasons that are independent from the involved participants:

   - ISIN suspension from settlement due to a reconciliation issue under Article 65 (2) and (6) of the RTS on CSD Requirements;

   - ISIN suspension from trading, such as for example under Article 32(1), Article 52(1), Article 69(2) of MiFID II or Article 40(1) of MiFIR;

   - settlement instructions involving cash settlement outside the securities settlement system operated by the CSD if, on the respective day, the relevant payment system is closed for settlement;

   - technical impossibilities at the CSD level that prevent settlement, such as: a failure of the infrastructure components, a cyber-attack, network problems, or T2S.

7. Additionally, ESMA consulted on two more scenarios where settlement fails would not be attributable to the participants:

   - settlement instructions involving securities under sanctions or anti-money laundering proceedings; and

- settlement instructions put on hold due to the order issued by a court, the police or similar authority with relevant mandate.

8. ESMA also consulted on the feasibility of ex-ante filtering of these cases, which has to be analysed separately.

Options considered and preferred option

Policy issue 1: Identifying the causes of settlement fails that are considered as not attributable to the participants

9. ESMA considered three policy options:

   - Option 1a: Maintaining the list as publicly consulted;
   - Option 1b: Narrowing down the list;
   - Option 1c: Expanding the list.

Preferred option

10. ESMA opted for expanding the list of proposed exemptions to two additional cases:

    - Risk management procedures at the CSD level foreseen in case of exceptional circumstances;
    - Settlement fails derived from technical or procedural limitations, mistakes, or malfunctions in the CSDs' systems, including CSDs rejecting instructions on an ISIN due to missing or incorrect master data, or deletion of instructions by the CSD due to errors not attributable to the instructing party.

Costs

11. ESMA understands that the selected option would have limited costs, if any. Most of the proposed exemptions represent current market practice after the publication of the CSDR Q&A in October 2022.

12. Some market participants expressed concern about a potential increase in the number of ex-post bilateral appeals to CSDs if the exemptions could not be filtered ex-ante. In this sense, there are two elements to consider:

    - first, the costs of bilateral appeals are attributable to level 1. From that perspective, the additional cases proposed should be excluded as not attributable to the market participants, but also because it is questionable whether the definition of "settlement fail" is met in those cases;

- second, as bilateral appeals are already current market practice due to the CSDR Q&As, consistency with the current market practice avoids the risk of an increase in the number of manual appeals.

Benefits

13. Incorporating the proposed amendments into the regulatory framework will provide clarity and legal certainty for market participants. Additionally, it will enhance transparency in the calculation of penalties.

Policy issue 2: ISIN suspension from trading

14. ESMA considered three policy options:

- Option 2a: ISIN suspension in any trading venue where the financial instrument is admitted to trading or traded;

- Option 2b: ISIN suspension in all trading venues where the financial instrument is admitted to trading or traded;

- Option 2c: ISIN suspension from trading in the most relevant market in terms of liquidity.

Preferred option

15. ESMA opted for the third option.

Costs

16. The costs of this option should be limited because:

- this case is already covered in the CSDR Q&As and exemptions should be managed by means of ex-post bilateral claims;

- the necessary data to assess whether the grounds for this exemption concur are provided free-of-charge and in a machine-readable format by ESMA: the identification of the most relevant market in terms of liquidity is available in FIRDS (currently used as "golden source" by CSDs) and the information about the trading suspensions can be found in SARIS. Moreover, this information should become even more accessible in the future by means of the consolidated tape;

- it does not make it necessary for CSDs to monitor whether a trading suspension has taken place in any of the trading venues in which an ISIN is admitted to trading or traded;

- it does not make it necessary to monitor whether the trading suspension has been extended to all trading venues where the instrument is admitted to trading or traded.

Benefits

17. Clarification of the scope of this exemption by making it clearer for CSDs and market participants how to apply it and narrowing down the necessary checks in case of suspension from trading of an ISIN, by focusing on one trading venue per ISIN. The CSDR Q&A published in 2022 did not specify the trading venue where the suspension should occur or the minimum duration of the suspension that would justify the exemption.

18. Ease of monitoring and implementation, based on publicly available sources offered by ESMA.

Policy issue 3: Ex-ante filtering of the settlement fails the underlying causes of which are considered as not attributable to the participants

19. ESMA considered two policy options:

- Option 3a: requiring CSDs to ex ante filter all the proposed cases;

- Option 3b: recommending CSDs to ex ante filter only the cases that are economically efficient in accordance with their own cost-benefit analysis.

Preferred option

20. ESMA opted for the second option, noting that no regulatory action was considered necessary at this stage.

Costs

21. Given the low number of settlement fails due to reasons not attributable to the participants, ESMA recommends that CSDs should only implement ex-ante filtering where their own cost-benefit analysis justifies it.

22. Moreover, ESMA understands that these cases are already currently managed by means of ex-post bilateral claims.

23. Where the number of settlement fails not attributable to the participants is too small to justify system changes, CSDs will maintain their current procedures for the ex-post management of claims. Therefore, there should not be any one-off costs related to updates of the CSDs' penalty mechanisms or of the systems of other market participants predicting/monitoring penalties where the number of instances of these cases is limited.

24. Some market participants noted that the administrative costs of managing ex-post bilateral claims often exceed the cost of the penalty itself. Not requiring ex-ante filtering would imply a cost for them. However, ESMA reiterates that the evidence gathered indicates that, overall, the settlement fails not attributable to the participants are limited. Therefore, the cost of managing the ex-post bilateral claims should be limited as well.

Benefits

25. The main benefit is that CSDs should only undertake the structural changes that are economically meaningful for them.

26. Another benefit of this approach is that it should not overly complicate the technical changes in the CSDs' systems while other arrangements have to be revised in the context of the transition to T+1.

8.4.2 Circumstances in which operations are not considered as trading

Problem identification

27. One of the changes brought by CSDR Refit refers to the need for further specification of the circumstances in which cash penalties are applicable in order to make the settlement discipline rules operational and better tailored to the diversity of market operations and transactions that can potentially be subject to the regime. As such, it becomes necessary to identify the operations that are not considered as trading for the purposes of exempting them from the scope of the settlement discipline.

Policy objectives

28. There are two main objectives to be considered:

- reducing the administrative burden and compliance costs of CSDs and market participants;
- ensuring a proportionate, effective, and efficient implementation of the settlement discipline regime.

Baseline scenario

29. As opposed to the previous case, there was no pre-existing market practice to exempt operations not considered as trading from the scope of the cash penalty regime.

30. ESMA consulted on five types of operations:

  - free-of-payment (FoP) securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral;

- market claims, corporate actions on stock, such as cash distributions (e.g. cash dividend, interest payment), securities distributions (e.g. stock dividend; bonus issue), reorganisations (e.g. conversion, stock split, redemption, tender offer);
- the process of technical creation of securities, meaning the transfer from the CSD's issuance account to the issuer's CSD account;
- creation and redemption of fund units on the primary market, meaning the technical creation and redemption of fund units (except for ETFs);
- realignment operations.

Options considered and preferred option

Policy issue 4: Identifying the operations not considered as trading

31. ESMA considered three policy options:

- Option 4a: maintaining the list as publicly consulted;
- Option 4b: narrowing down the list;
- Option 4c: expanding the list.

Preferred option

32. ESMA finally opted for expanding the initial list, while streamlining the cases originally consulted, in light of the technical feedback received.

Costs

33. In the absence of previous market practices or regulation, the identification of the operations not considered as trading should imply an increase in the costs, mostly for CSDs. However, those additional costs should be allocated to Level 1 rather than to the current technical advice.

34. The identified costs from the proposal are the following.

35. Changes to CSDs' penalty mechanisms to apply ex-ante filters. Due to the number of cases in which it would be necessary to apply these exemptions, it would be too costly to manage them by means of ex-post bilateral claims. These may potentially be replicated by market participants predicting/monitoring these penalties. However, these adjustments are expected to require a one-off investment and are unlikely to impose significant ongoing costs. Moreover, ESMA has received feedback from the CSD community suggesting that these costs should be low to medium (at least in the case of submission of identical trading type codes).

36. Given the lack of harmonisation of transaction type codes, the number of bilateral ex-posts appeals is expected to increase. Overall, the operational costs for the management of bilateral ex-post claims (both for participants and CSDs) should be compensated by the savings experienced by market participants to a certain extent. Several CP respondents noted that the operational costs of bilateral claims may exceed the costs of the penalties themselves. In this respect, ESMA would like to mention its recent Technical Advice to the EC on the CSDR penalty mechanism, which recommends an overall moderate increase in penalty rates in most of the asset classes.

Benefits

37. Such refinements should prevent the generation and processing of cash penalties that do not incentivise improved settlement efficiency, thereby reducing administrative burdens.

38. Greater clarity on the scope of penalties will improve predictability and assist market participants in aligning their systems and practices accordingly.

39. Furthermore, simplifying penalty calculations will enhance transparency, making the process more comprehensible and manageable for all stakeholders.

Policy issue 5: Whether to exempt or not FoP securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral

40. ESMA considered two policy options:

- Option 5a: exempting the (de)mobilisation of collateral for ESCB credit operations and for other purposes listed in Annex V of Guideline ECB/2024/22;

- Option 5b: exempting FoP securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral regardless of the parties involved.

Preferred option

41. ESMA opted for the proposal that only covers the (de)mobilisation of collateral for ESCB credit operations or for other purposes listed in Annex V of Guideline ECB/2024/22.

Costs

42. The main costs will arise due to the need to identify ex-ante these transactions and filter them so that they do not generate a penalty (i.e. the same as for other exemptions under the category of “circumstances in which the operations are not considered as trading”).

43. However, ESMA understands that those costs should be, to a certain extent, limited:

44. A series of transaction type codes (Central Bank Collateral Operation, COLI, COLO, REPU) are already in use. However, some of these codes are also used in transactions between private parties. A harmonisation in the use of the codes in the context of (de)mobilisation of collateral for ESCB credit operations or for other purposes listed in Annex V of Guideline ECB/2024/22 is therefore needed;

45. At the same time, there might be alternative means to identify these transactions, namely considering through single-purpose accounts dedicated solely to ESCB credit operations or for other purposes listed in Annex V of Guideline ECB/2024/22.

Benefits

46. This exemption should prevent the generation and processing of cash penalties that do not incentivise improved settlement efficiency, thereby reducing the administrative burden.

47. Transfers of collateral that support trading activity between private individuals remain in the scope of cash penalties. It is worth noting that many of these FoP transfers are “non-trades” on which “real” trades depend. A broader exemption could have financial stability implications if collateral is not delivered on time. Moreover, based on the data reported by CSDs under Article 7(1) of CSDR, ESMA notes that the number of instructions related to collateral management operations entered into the securities settlement systems operated by EEA CSDs is not very high (even if their value is high) and the settlement fail rates for collateral management operations are very low. As a result, the costs to implement such change when private parties are involved in these operations and, more importantly, the potential negative effect on the market outweigh the benefits.

Policy issue 6: Exempting the technical creation and redemption of ETF shares/units from settlement discipline

48. ESMA considered two policy options:

- Option 6a: exempting the technical creation and redemption of ETF shares/units on the primary market from settlement discipline;

- Option 6b: not exempting the technical creation and redemption of ETF shares/units on the primary market from settlement discipline while exempting the technical creation of securities and the technical creation and redemption of other fund units and shares.

Preferred option

49. ESMA recommends exempting the technical creation/redemption of ETF shares/units i.e., in the case of creation, crediting the ETF shares/units to the ETF issuer's/transfer agent's CSD account after the delivery of the basket of underlying securities/ETF shares/cash. However, the rest of the steps within the 'primary market operations' for ETFs should remain within the scope of cash penalties.

Costs

50. CSDs should implement ex-ante filters to prevent imposing a penalty in case there is a delay at this stage.

Benefits

51. This exemption should prevent the generation and processing of cash penalties that do not incentivise improved settlement efficiency, thereby reducing administrative burdens. Particular attention has been paid to maintain within the scope of cash penalties those phases that could prevent settlement on the intended settlement date.

52. Given that the technical creation/redemption of securities, fund units and shares and ETF shares should be out of the scope of cash penalties, the ex-ante identification of these technical transactions by CSDs should be simpler and less costly.

Policy issue 7: Ex-ante filtering of the operations not considered as trading

53. ESMA considered two policy options:

- Option 7a: recommending CSDs to ex ante filter all the proposed cases irrespective of existing technical capabilities;
- Option 7b: recommending CSDs to ex ante filter settlement instructions taking into account the existing technical capabilities e.g., settlement instructions with identical transaction codes or pre-identification of single-purpose account dedicated solely to Eurosystem credit operations.

Preferred option

54. ESMA opted for the second option, while noting that CSDs should apply these exemptions even if ex ante filtering is not practicable because the participants did not submit identical transaction type codes or when the pre-identification of a single-purpose account has not been made. In these cases, the exemption should be applied by means of ex-post bilateral claims.

Costs

55. The identified costs from the proposal:

56. Changes to CSDs' penalty mechanisms to apply ex-ante filters based on the transaction type code (settlement instructions that have identical transaction codes corresponding to the list of exemptions based on operations that are not considered as trading). These may potentially be replicated by market participants predicting/monitoring these penalties. However, there are several points to be made in this respect:

57. Most of these costs should be allocated to level 1, since there was no prior requirement in this respect;

58. These adjustments are expected to require a one-off investment and are unlikely to impose significant ongoing costs;

59. ESMA has received feedback from the CSD community suggesting that these costs should be low to medium at least in relation to the identification of settlement instructions with identical trading codes.

60. Changes to the market participants' current market practices, to identify a single-purpose account for the purpose of the (de)mobilisation of collateral for ESCB credit operations;

61. Due to the lack of harmonization in transaction type codes, the number of bilateral ex-post appeals is expected to rise. Several CP respondents noted that the operational costs of bilateral claims may exceed the costs of the penalties themselves. In this respect, ESMA would like to mention its recent Technical Advice to the EC on the CSDR penalty mechanism, which recommends an overall moderate increase in penalty rates in most of the asset classes. However, there will be a natural incentive for the industry to collaborate and reduce these cases through further harmonization. Consequently, the number of bilateral claims is expected to decrease over time. Overall, the operational costs for the management of bilateral ex-post claims (both for participants and CSDs) should be compensated, to a certain extent, by the savings experienced by market participants;

62. One financial market infrastructure identified as a cost that participants and CSDs should undertake the necessary testing to check that the filtering mechanism is correctly implemented.

Benefits

63. ESMA takes the point made by some trade associations noting that, as opposed to fails "not attributable to the participants", the exemption related to operations not considered as trading should apply to large volumes of operations.

64. From that perspective, the main benefit of filtering ex ante these exemptions will be the savings for participants derived from the lower number of cash penalties paid and a decrease in the resources allocated to the ex-post management of the unduly paid penalties. However, as noted in the section related to costs, it can also be argued that, as opposed to the causes of settlement fails not attributable to the participants, some of these exemptions have not been operational in the past and the lack of harmonisation of transaction type codes may make the ex-ante filtering less effective.

65. ESMA notes that the ex-post management of these cases also constitutes a cost for CSDs. Therefore, the expectation to reduce such cost should incentivise CSDs and market participants to harmonise the use of transaction type codes, expanding the use of the ex-ante filters.

Policy issue 8: Entry into application of the exemptions based on operations not considered as trading

66. ESMA considered three policy options for the deferred entry into application of the exemptions based on operations not considered as trading:

- Option 8a: Deferred application by 24 months after the publication of the Commission Delegated Act in the Official Journal of the EU;
- Option 8b: Deferred application by at least 12 months after the publication of the Commission Delegated Act in the Official Journal of the EU;
- Option 8c: Immediate application after the publication of the Commission Delegated Act in the Official Journal of the EU.

Preferred option

67. ESMA recommends the deferred application by at least 12 months after the publication of the Commission Delegated Act in the Official Journal of the EU, and, to the extent possible (depending on the publication of the Commission Delegated Act in the Official Journal of the EU) no later than by the end of Q2 2027.

Costs

68. The main cost of deferring the entry into application of the exemptions based on operations not considered as trading is the economic burden for participants that will have to bear the cost of the unduly imposed cash penalties in the meantime.

69. However, an earlier entry into application of the exemptions would also imply a cost for both CSDs and participants because, in the absence of ex-ante filters, these cash penalties should be managed by means of ex-post bilateral claims. As opposed to the causes of settlement fails not attributable to participants this cost should be relevant for both of them, because the operations benefiting from this exemption are numerous and

the cost of managing the bilateral claims may exceed the cash penalties themselves in some cases.

70. Even with the deferred application, many of these operations might still be managed by means of ex-post bilateral claims due to the lack of harmonisation and consistency in the use of transaction codes.

Benefits

71. The main benefit of this approach is that CSDs will have sufficient time to implement the changes where appropriate. Additionally, the implementation of the filters should not collide with any structural changes undertaken in the context of T+1, which are expected to take place in Q3 of 2027.

8.5 Annex V- Summary of proposals

72. The proposals presented in the Final Report are summarised below.

73. ESMA considers that the following cases should not trigger the application of cash penalties and MBI if they generate settlement fails, given that such settlement fails are not attributable to the participants in the transactions:

a. ISIN suspension from settlement due to a reconciliation issue under Article 65 (2) and (6) of the RTS on CSD Requirements;

b. Technical impossibilities at the CSD level that prevent settlement, consisting of a failure of the infrastructure components, a cyber-attack, network problems or technical (IT) issues in the system of the CSD;

c. ISIN suspension from trading on the most relevant market in terms of liquidity, if the suspension lasts for the entire trading day;

d. Settlement instructions involving cash settlement if, on the respective day, the relevant payment system is closed for settlement;

e. Settlement instructions involving securities or issuers under sanctions or anti-money laundering proceedings;

f. Settlement instructions put on hold due to an order issued by a government institution, court, regulatory authority, or other similar authority with a relevant mandate;

g. Risk management procedures at the CSD level foreseen in an exceptional manner;

h. Situations derived from technical limitations, mistakes, or malfunctions in the CSDs' systems, including CSDs rejecting instructions on an ISIN due to missing or incorrect master data that is not due to participants' fault, or deletion of instructions by CSDs due to errors not attributable to the instructing participants.

74. ESMA is of the opinion that the following circumstances should not be considered as trading for the purpose of the application of cash penalties and the MBI:

a. (De)mobilisation of collateral for ESCB credit operations or for the purposes listed in Annex V to Guideline ECB/2024/22;

b. Market claims and corporate actions on stock such as cash distributions (including cash dividend, interest payment), securities distributions (including stock dividend, bonus issue) and reorganisations (including conversion, stock split, redemption, tender offer);

c. The process of technical creation of securities, i.e. the transfer from the CSD's issuance account to the issuer/issuer's agent CSD account or the initial recording of securities in the issuer/issuer's agent CSD account;

d. Share registration, i.e. the process of officially recording the transfer of ownership of shares from one party to another in the issuer's share register maintained by the CSD;

e. The process of technical creation and redemption of fund units or shares on the primary market (including ETFs shares), i.e. the crediting (in the case of creation) or the debiting/elimination (in the case of redemption) of the fund units or shares from the fund/transfer agent CSD account;

f. Technical realignment operations between CSDs including T2S technical realignment operations.

75. As regards the practical implementation of the exemptions, ESMA is of the opinion that:

Practical implementation of exemptions based on underlying causes of settlement fails that are considered as not attributable to the participants in the transactions

76. At this stage, ESMA does not recommend ex-ante filtering of settlement fails the underlying causes of which are not attributable to the participants to the transactions. It should be left to the individual CSDs to determine whether setting up ex-ante filters compensates the cost of dealing with ex-post bilateral claims on an on-going basis.

Practical implementation of exemptions based on the circumstances in which operations are not considered as trading

77. ESMA recommends CSDs to take the necessary steps to ex-ante filter settlement instructions that have identical transaction codes corresponding to the list of exemptions based on operations that are not considered as trading.

78. ESMA does not think that transaction type should become a mandatory matching field, given that it may lead to an increase in settlement fails, due to inconsistencies in the usage of transaction codes by CSD participants.

79. ESMA also recommends exploring the possibility of ex-ante filtering of (de)mobilisation of collateral in the context of ESCB credit operations or for the purposes listed in Annex V to the Guideline ECB/2024/22 on the basis of the accounts.

80. ESMA notes that CSDs and participants should maintain the capacity to manage these exemptions by means of ex-post bilateral claims where it has not been possible to apply the ex-ante filter.

81. It should be assessed whether a regulatory requirement should be introduced in the legal framework at a later stage.

82. Regarding the eventual alignment between the cash penalty regime and the buy-in regime, ESMA holds the following position:

83. Firstly, ESMA notes that the replies received regarding the **circumstances in which operations are not considered as trading** do not differ on whether certain of these operations should be excluded from the scope of the MBI but on how broad this category should be.

84. Secondly, ESMA also notes the diverse feedback received in the case of underlying **causes of settlement fails not attributable to the participants**. The proposal received considerable support (to be complemented with additional cases). However, a significant number of respondents supported different scopes between the cash penalties regime and the MBI. ESMA would like to underline that this approach questions Article 7a(7)(a) of CSDR Refit, which establishes the alignment between both regimes.

85. Therefore, it does not seem possible to de-couple the scope of both regimes. ESMA considers that the scope of the cash penalties and the MBI should coincide as regards settlement fails not attributable to the participants, without prejudice of additional causes that should be consulted if necessary.

86. As regards the point made by several stakeholders in relation to additional cases that should be exempted from the MBI, Article 7a(7) of CSDR Refit provides for such additional exemptions[62] .

87. Therefore, ESMA believes that a consultation on additional cases should take place, if necessary, in accordance with Article 7a (15) of CSDR Refit[63].

[62] The mandatory buy-in process referred to in paragraph 4 shall not apply to:
(a) the settlement fails, operations and transactions listed in Article 7(3);
(b) securities financing transactions;
(c) other types of transactions that render the buy-in process unnecessary;
(d) transactions that fall within the scope of Article 15 of Regulation (EU) No 236/2012.

[63] ESMA shall, in close cooperation with the members of the ESCB, develop draft regulatory technical standards to further specify: […]
(d) other types of transactions that render the buy-in process unnecessary as referred to in paragraph 7, point (c), such as financial collateral arrangements or transactions that include close-out netting provisions; […]