EACH Response – ESMA consultation on Technical Advice on the CSDR Penalty Mechanism

February 2024

Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties (CCPs) in Europe since 1992. CCPs are financial market infrastructures that significantly contribute to safer, more efficient and transparent global financial markets. EACH currently has 18 members from 14 different European countries. EACH is registered in the European Union Transparency Register with number 36897011311-96.

EACH welcomes the opportunity to contribute to this initiative in improving settlement efficiency via the ESMA Consultation Paper on Technical Advice on the CSDR Penalty Mechanism. The EACH response focuses on the potential implications of progressive penalty rates by length and by value.

EACH answers

Q.1: Do you agree with ESMA's proposal? Which Option is preferable in your view? Please also state the reasons for your answer.

EACH welcomes the initiative to improve settlement efficiency. Regarding the ESMA proposals, we share the following feedback on progressive penalty rates by value in the answer to question 30 and the EACH view on progressive penalty rates by length below.

Progressive penalty rates by length

With current fixed penalty rates over the different days late of an instruction, the days late of pending instructions in remaining seller/buyer constellation do not make a difference in the CCPs total net penalty balance (paid/delivered). With progressive penalty rates on days late, the older pending delivery instruction could mean a higher penalty to be paid to the CCP than the CCP must pay to the remaining buyer.

Q.30: Another potential approach to progressive penalty rates could be based not only on the length of the settlement fail but also on the value of the settlement fail. Settlement fails based on instructions with a lower value could be charged a higher penalty rate than those with a higher value, thus potentially creating an incentive for participants in settling smaller value instructions at their intended settlement date (ISD). Alternatively, settlement fails based on instructions with a higher value could be charged a higher penalty rate than those with a lower value. In your view, would such an approach be justified? Please provide arguments and examples in support of your answer, including data where available. What costs and benefits do you envisage related to the implementation of this approach?

EACH is opposed to the idea of progressive penalty rates being based on the value of the settlement fail, as for CCPs this approach will be unnecessarily cumbersome and cause imbalances, as there is a largely 'n:m' relationship of members in an ISIN clearing case (e.g. One member delivers in an ISIN "100" to CCP, CCP delivers two times "50" to other members), resulting instructions after clearing differing on CCP sell and buy side in related instruction value. In sum, progressive penalty rates based on failed value raises the risk for systematic imbalances for CCPs in both directions.

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