esma European Securities and Markets Authority

Final Report

Technical Advice under the CSD Regulation

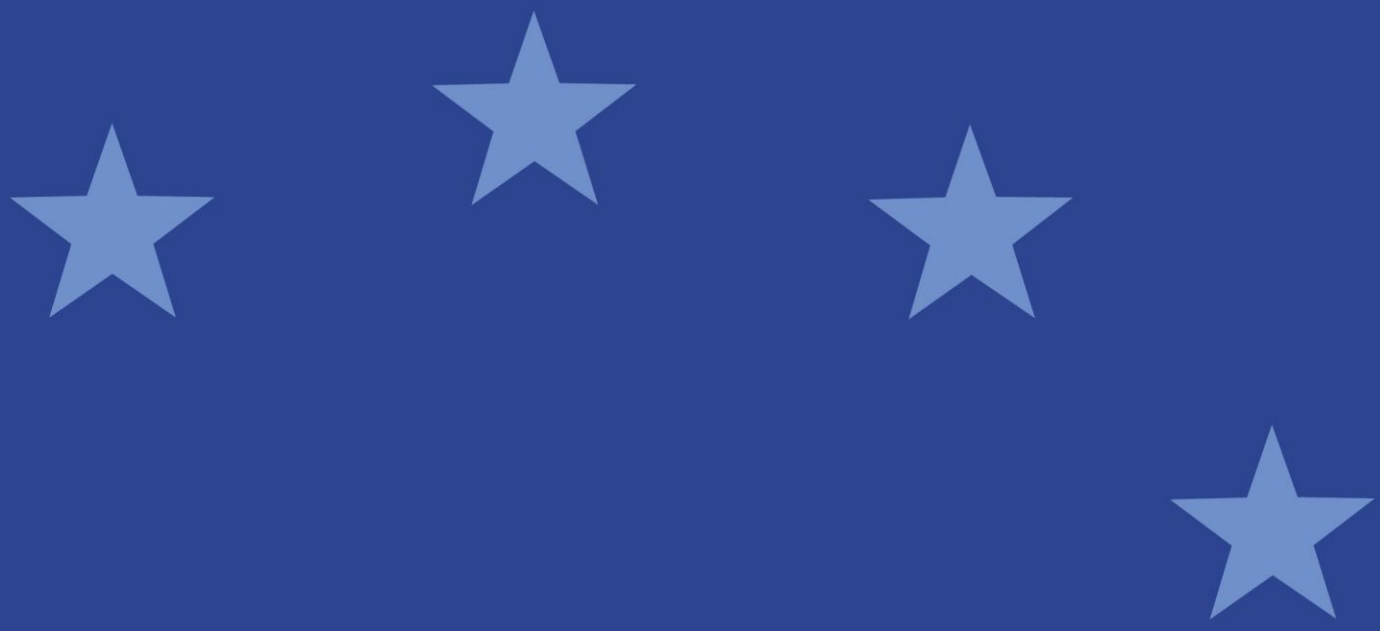

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Table of Contents

1 Executive Summary

Reasons for publication

1. On 7 March 2012 the European Commission (EC) proposed a Regulation 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). On 18 December 2013, the European Parliament and the Council of the European Union agreed the CSDR text. On 26 February 2014, the Permanent Representatives Committee, on behalf of the Council of the European Union, confirmed the agreement with the European Parliament. On 15 April 2014, CSDR was formally adopted by the European Parliament. On 16 July 2014 the European Parliament and the Council published the agreed text, ready for publication in the OJ. Finally, the CSDR was published in the OJ on 28 August 2014 and entered into force on 17 September 2014.

2. In addition to the mandate to draft technical standards therein, on 23 June 2014 ESMA received a provisional request (mandate) from the EC to provide technical advice to assist the EC on the possible content of the delegated acts required by two CSDR provisions: penalties for settlement fails and the substantial importance of a CSD. On 2 October 2014, following the publication of the CSDR in the OJ and its entry into force, ESMA received the confirmation[1] from the EC that the respective mandates should no longer be considered as provisional but as final. ESMA is required to submit the technical advice to the EC by 18 June 2015, in tandem with the draft technical standards under CSDR.

3. ESMA consulted stakeholders on the draft technical advice from 18 December 2014 to 19 February 2015.

Contents

4. This Final Report covers the feedback following the public consultation, the technical advice on penalties for settlement fails and on the substantial importance of a CSD, as well as an impact assessment regarding the proposed measures.

On penalties for settlement fails

5. The CSDR introduces an obligation to settle instructions on the intended settlement date and provides for the application of a daily cash penalty for failed settlement instructions.

[1] http://www.esma.europa.eu/system/files/20141002_esma_-_csdr_mandates.pdf

6. The EC has asked ESMA to provide them with technical advice on:

i. the parameters for calculating the cash penalty that a CSD will normally charge for settlement fails (i.e. the basic amount of a cash penalty);

ii. the circumstances that may justify an increase of the basic amount of the cash penalty and the parameters for the calculation of such an increase, whilst applicable under an automated system;

iii. the circumstances that may justify a reduction of the basic amount of the cash penalty and the parameters for the calculation of such a reduction whilst applicable under an automated system; and

iv. how to adapt the parameters for the calculation of cash penalties in the context of a chain of interdependent transactions and whether there are cases where this would not be possible (e.g. the chain would not be visible).

On the substantial importance of a CSD

7. One of the objectives of CSDR is to complete the internal market by also fostering an internal market for CSD services. To achieve this, Article 23 CSDR allows any EU-registered CSD to provide its services in any Member State of the Union (EU passport).

8. Article 24 CSDR provides for various cooperation measures between home and host Member States' competent authorities where a CSD provides its services cross-border. More specifically, Article 24(4) of CSDR provides that home and host competent authorities shall establish formal cooperation arrangements for the supervision of a CSD where the activities of such CSD have become "of substantial importance for the functioning of the securities markets and the protection of the investors" in the host Member State.

9. In order to implement this, Article 24(7) CSDR requires the EC to adopt delegated acts concerning measures for establishing the criteria under which the operations of a CSD in a host Member State could be considered "of substantial importance for the functioning of the securities markets and the protection of the investors" in the host Member State.

10. On this basis, the EC has asked ESMA to consider its own experience and from that of national authorities concerning the provision of CSD services and provide the EC with technical advice on:

i. initial recording of securities in a book-entry system ('notary service');

ii. providing and maintaining securities accounts at the top tier level ('central maintenance service'); and

iii. operating a securities settlement system ('settlement service').

The EC has also asked ESMA to consider the three core services in the cases of:

i. market consolidation affecting host Member States; and

ii. branching into host Member States.

11. The EC provided ESMA with a number of principles and details on the above bullet-points, copied in the Annex and analysed under each appropriate section of the technical advice.

Next Steps

12. ESMA is aware of the need to use consistent data at EU level for the calculation of the indicators for determining substantial importance. It may therefore be necessary to establish a mechanism for the collection, processing and aggregation of the data necessary for the calculation of the indicators. ESMA is currently analysing the most appropriate way to establish such a mechanism.

Acronyms and definitions used

CCP	Central Counterparty
EC	European Commission
CMU	Capital Markets Union
CP	Consultation Paper
CSD	Central Securities Depository
CSDR	Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012
ESMA	European Securities and Markets Authority
ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC
ETF	Exchange-traded fund
EU	European Union
FOP	Free of Payment
ICSD	International Central Securities Depository
MIFID	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)
MS	Member State
OJ	The Official Journal of the European Union
OTC	Over-the-counter
RTS	Regulatory Technical Standards
SSS	Securities Settlement System

2 Penalties for Settlement Fails

1. In order to prepare for the technical advice, ESMA has analysed the penalty mechanisms that are currently in place in some markets at CSD and CCP level, in and out of the Union. Those models are all different and it is not possible to conclude whether one model is more efficient than the others. No single current approach was favoured and all mechanisms were used as a source of inspiration for the purpose of this technical advice.

2. In the mandate to ESMA, the Commission shares its view that the penalty should take into account the value of the transaction in order to be deterrent and proportionate and stresses that the parameters should be sufficiently simple to be applied via an automated system.

3. In the Discussion paper, there was no detailed analysis on the level of the cash penalty given that ESMA had no mandate yet. Nonetheless, stakeholders indicated their strong preference for a simple approach that would ease an automated implementation and limit associated costs.

4. In the consultation paper, the analysis of the proposed approach was shared and stakeholders provided more substantial comments.

5. Some respondents consider that the penalty rates are too high and not sufficiently granular, in particular for the SME growth market instruments. They stress that especially for shares the liquidity of the financial instruments should be taken into account. For fixed income, stakeholders are more in favour of a single category for both sovereigns and corporates.

2.1 Parameters for calculating the basic cash penalty

6. In its mandate the European Commission indicates some principles for ESMA to take into account when preparing the technical advice. The cash penalty should relate to the value of the transaction that fails to settle and the principle of neutrality concerning the securities holding models should apply. It means that a given securities holding model should not be significantly disadvantaged.

7. The Commission also notes the deterrent characteristic of the penalties that should lead to an improvement of the levels of settlement efficiency, to the extent possible.

8. Finally, the cash penalty should be proportionate and take into consideration the specificities of the different asset types, the liquidity and category of transactions.

9. In this framework, in order to determine the relevant parameters, ESMA has analysed (1) the basis upon which the penalty should be calculated and (2) the penalty formulae or rate that should be applied on that basis in order to calculate the penalty amount.

10. It is important to keep in mind that the approach for the calculation of the daily basic cash penalty relates to settlement instructions that fail to settle on ISD and apply both to fails due to lack of cash and lack of securities.

2.1.1 The basis for the cash penalty calculation

11. Depending on the transaction underlying the settlement instruction (e.g. repo, straight sale), the price indicated in the instruction may substantially vary from one instruction to the other for the same financial instruments. It could even be set to zero in the case of FOP settlement instructions. Given that the penalty should have a deterrent effect, it would not be appropriate to consider the price set in the settlement instruction for the purpose of the penalties calculation.

12. For the purpose of harmonizing the approach across the Union, and in order to facilitate and simplify the calculation of penalties among CSDs and their participants, the basis on which the penalty amount should be calculated, should be the same for an identical number of financial instruments which are failed to be delivered on a given ISD or thereafter. This implies that the variable component that takes into account the value of the transaction that fails to settle should be calibrated not on the price of the specific transaction that is failing, but on a reference price of the instrument involved. This reference price could be used for all calculations of penalties involving such instrument on a given day, across participants, and across CSDs.

13. Furthermore, the homogenisation of the ad valorem component reflected above addresses the issue of FOP settlement instructions and non-market considerations, for instance, in the context of cleared settlement instructions or, settlement instructions that do not individually present an economic rationale. The homogenisation also respects the proportionality and effectiveness of the penalty.

14. In order to determine the price to be used, one should refer to the closing price of the most relevant market for the financial instrument as determined under article 4(6)(b) of Regulation (EU) No 600/2014. Alternatively, when such a closing price is not available, the price of the most liquid trading venue for the relevant instrument should be used. The price should reflect the market price and should be similar across CSDs. When none of these are available, a pre-determined methodology to calculate the relevant price should be used, referring as much as possible to criteria related to the market's data such as market prices available across trading venues or brokers.

15. CSDs should implement a common approach so that the price would be the same for similar financial instruments in all CSDs. It is particularly important in order to create a single post-trade market: wherever the CSD is located within the Union, the same price should be used for similar instruments in order to determine the penalty.

16. For a failure to settle an instruction on a given day, the same price should be used to determine the penalty whether the calculation is performed on that day when the instruction is matched or entered before the intended settlement date, or backwards

when the instruction matches after intended settlement date or is entered into after intended settlement date. The price of each day where the instruction fails to settle should be used as a basis. This would protect the mitigation effect of the collection and redistribution mechanism of the penalty in case of a chain of fails.

Partial deliveries

17. In the proposed draft RTS, CSDs are required to offer the "partials" functionality to their participants. This measure aims at facilitating the settlement, even for a part, of the settlement instruction. Further, the RTS also provides that partial settlement shall be applied the day before the end of the extension period. Given the limited period of time between the settlement fail and the day before the end of the extension period, and in view of the cost for implementing a penalty system, it is proposed to adopt a pragmatic approach and apply the penalty to the instruments that fail to settle irrespective of whether the instruments or the cash were available in the account of the participant.

2.1.2 The penalty rate

18. Following the mandate received by the Commission, ESMA has considered the specificities of the different asset types, the liquidity and category of transactions when analysing the approach to be recommended.

The category of transactions

19. Most of the settlement instructions do not include information on the category of transaction they relate to. Indeed, the instruction does not indicate whether the underlying transaction is for instance a loan of financial instruments and part of a larger operation.

20. Furthermore, in the context of chains of fails, the transaction type may introduce a different penalty depending on the type of transaction and could create imbalances between the different parties in the chain limiting the mitigating effect of the redistribution of the penalties.

21. In view of the above, ESMA is of the view that the category of underlying transaction to which the settlement instruction relates should not lead to different penalty rates.

The asset type and liquidity of the financial instruments

22. The asset type of the financial instruments provides information on the settlement structure that is applicable and which may differ from one asset type to another. For instance, the settlement of ETFs involves a different pre-settlement structure than the settlement of sovereign bonds or shares. It is therefore important to analyse the asset type of the financial instruments in order to determine the penalty rate.

23. Liquidity is important as it will impact how difficult or easy it is to cure the settlement fail. The less liquid a financial instrument is, the most difficult it will be to cure the settlement fail. It is therefore an important element to consider when setting the penalty rate.

24. It is therefore necessary to consider the asset type of the financial instruments and their liquidity in order to determine an appropriate level for the penalty.

25. As the liquidity of a financial instrument may be complex to ascertain and can change rapidly depending on specific and contingent market conditions, considering the need to automate the system, it is not the liquidity of the specific financial instrument on the day of the fail that should be considered. Instead, consideration of the expected liquidity based on the asset type is more important. This approach would be in line with the requirement for simplicity and for automation and it would allow due consideration of the liquidity of the relevant instruments as well as of the asset type.

26. In particular, the penalty rate should be set in a manner that duly considers the liquidity of the instruments in the following manner: the penalty rates are higher for the most liquid instruments. This would be particularly appropriate for shares where the MIFID classification could be leveraged and used for the current purpose.

27. For other instruments such as those traded on SME growth markets, given their particularity and the need to support them, they may be more difficult to source and it may therefore be more difficult to cure the settlement fail. The CSDR provides for a 15 days extension period for those instruments, which means a longer period of time during which the penalty would be applied pending the end of the extension period where a buy-in process could kick-in. In line with this approach, the penalty rate for those instruments should be specific.

28. For bonds, the liquidity may be relevant to a lesser extent and the settlement feature would differ from that of shares. Furthermore the measure of the liquidity would be more complex. Indeed, the MIFID measure of the liquidity for bonds relates to transparency. Given the different purpose that the CSDR is intended to achieve, it would not be appropriate to use that definition of bonds liquidity for the purpose of the CSDR. As a result it would be appropriate to apply a different penalty rate for bonds. However, it is important to note that the features of government bonds (including regional bonds) and corporate and other bonds are different and therefore a distinction should be made between them and a single rate should apply to corporate bonds and a different single penalty rate should apply to government bonds (including regional bonds).

29. For other financial instruments such as depository receipt, emission allowances, ETF, they may have a different pattern impacting on the timeframe of their settlement. They may be more difficult to get through the receiving participant. To a certain extent, they could be considered in conjunction with illiquid shares.

30. The aim would be to have penalty rates which would strongly incentivise the borrowing of instruments that have a liquid market, are easy to source and have a standard settlement pattern. However, for the less liquid instruments, or those that may be more difficult to source (for instance sovereign bonds that are usually part of large transactions) or those that have a particular settlement pattern, a lower penalty rate would have a deterrent

effect and would not penalise excessively these types of instruments whilst maintaining the smooth functioning of the market.

The recommended approach

31. In order to determine the rate that should be applied for the penalties rate per asset type/liquidity, it is important to note that the penalty is not structured to compensate for the loss that a counterparty may suffer and that is part of the contractual arrangement between the counterparties. Therefore it is not designed to replicate exactly the loss incurred by the failed participant, or the gains achieved by the failing participant. The purpose of the penalties is to be sufficiently deterrent and should introduce the desired incentives to prevent and reduce settlement fails. It is also an add-on to any claim in compensation that the failed party may contractually have over the failing counterparty.

32. For the purpose of calibration, and so as to advise levels that are deterrent and proportionate, ESMA considered the effects of the penalty for participants in view of the costs and consequences of a failed trade.

33. Considering the effects of a failed trade, and assuming that the settlement will eventually be carried out at a later date as opposed to the trade being cancelled, ESMA considers appropriate for the purpose of the analysis to take as a framework the liquidity and asset type of the financial instruments, the settlement pattern and length of the period during which the penalty could apply, the costs for curing the fail for instance through loan of financial instruments.

34. Regarding the spreads for securities borrowing, their range varies according to the value either as collateral for financing purposes, in which case the securities are qualified as “general collateral”, with a spread of borrowing above money market rate (the party that borrows the money pays on top of money market rate a spread because he is doing the transaction for financing purpose), or because of their specific nature in which case the securities are qualified as “special” (because securities encounter a corporate action, a dividend, because they are sought by market participants).

35. ESMA considered the possibility of linking the penalty rate to the prevailing market conditions for borrowing the security on the securities lending market, plus a mark-up to introduce the desired incentives. However, this approach was considered too complex to be implemented and maintained.

36. Indeed, prices are security specific. The above approach would introduce excessive granularity in the calculation of the penalty. Prices may also be very volatile which would introduce uncertainty in the determination of the penalty. Furthermore, prices are formed on OTC markets, and often not transparent, leading to difficulty for CSDs to ascertain them. As a result, the complexities introduced by this solution seem disproportionate and not adding significantly to the benefits of a simpler solution.

37. Considering the need to automate the penalty mechanism, a penalty rate in the form of a set table of values considering the asset type and liquidity, their settlement pattern and

period during which he extension period could apply which is simple to automate, delivers certainty to participants, and achieves the objectives of deterring settlement fails.

38. In this framework, ESMA has considered the specificities of different asset types or asset classes.

Shares

39. Usually shares would be the least problematic in view of the standardisation of the settlement pattern. However, the ability to source them on the market in order to cure a fail could very much vary depending on their liquidity. The definition of liquid shares in MIFID could be used for the purpose of the classification for the penalty rate. The MIFID information related to the liquidity of the shares is publicly available and regularly updated.

40. Liquid shares should be subject to a higher penalty rate than illiquid shares or other instruments that have a less standard settlement pattern. This approach would strongly disincentive unavailability of securities in a context where sourcing them is least disruptive to the market. Furthermore shares are most likely to be involved in long chains of fails, and a high penalty incentivises participants to break the chains of fails and address the issue of limiting multiple buy-in.

Fixed Income (bonds)

41. In defining penalties for government bonds, due consideration is given to the typical large size of these transactions and their importance for the financial system. Therefore it is advised that a smaller coefficient be applied to government bonds, which are normally large in size and involved in transactions which are extremely sensitive to even small price variations. A relatively small penalty should be sufficiently effective as a deterrent and an incentive to remediated failed chains.

42. For corporate bonds, the approach should be adapted from that proposed for government (including regional and municipal) bonds as these instruments have a different liquidity profile than government bonds and transactions in these financial instruments are smaller in size. The penalty should therefore be low but higher than that for government bonds. Corporate bonds should be understood as including bonds other than government bonds and SME growth market bonds that are a specific category.

43. Given the specificities of the SME growth markets bonds, it is important to consider the related bonds in a separate category. This category of instruments benefits from a longer extension period than other instruments which means that the penalty would potentially apply for a longer period of time. In order to consider the relevant timeframe and have a deterrent effect, the penalty level should be lower than for other corporate bonds but higher than for sovereign bonds given the smaller size of the transactions.

Other financial instruments

44. The approach to other financial instruments is motivated by the fact that these will often be OTC bilateral transactions, or relates to financial instruments such as ETF, DR, emission allowances, which may be less liquid that the bonds instruments. Counterparties could face each other directly or have a less liquid market, or trade in instruments with a non-standard settlement pattern. In these cases a higher penalty that for fixed income should be enforced to ensure settlement discipline. However, the penalty should not be higher than for shares in view of the volume and size of the transaction on such financial instruments. They should be considered in the same category as illiquid shares in order to reflect their less-standard features.

Cash

45. Fails due to a lack of cash should be subject to an equal rate for all transactions, given that the cause of the fail is always due to a lack of cash and this is independent from the type of transaction or financial instruments to be bought. Therefore the penalty should be particularly deterrent and not related to unavailability of the instrument to be settled, but only to temporary lack of cash of a participant or one of its clients.

46. The borrowing cost should be considered for the basis of the calculation of the penalty, as one of the remedy to avoid failing would be to borrow the missing cash. In the case of cash this borrowing cost is widely available in a transparent manner. Against this background, the most appropriate rate for fails to deliver cash should be the official discount rate for the relevant currency. However a floor should be set in order to maintain the deterrent effect when interest rates are negative.

47. In view of the economic circumstances, negative interest rates should be considered. In order to maintain the deterrent effect of the penalty mechanism, we propose to set a floor so that the impact of potential negative interest rate on the amount of the penalty would be mitigated.

48. Most stakeholders that expressed a view in respect of the penalty rate called for a limited number of categories to support a cost effective implementation of the cash penalty system.

49. In order to propose appropriate penalty rates ESMA has considered the above as well as the liquidity of the markets for the different asset types, the need to provide a strong incentive for enhancing settlement efficiency whilst preserving the smooth functioning of the markets. As a result, and in order to limit the number of categories of rates to apply for automation reasons, ESMA considers as appropriate the following levels for the calculation with regard to the penalty rates:

Asset Type/liquidity	Daily flat penalty rate
Liquid shares	**1.0bp**
Illiquid shares and others financial instruments (such as ETF, certificates, DR, etc.)	**0.5bp**
SME Growth Market shares and other financial instruments	**0.25bp**
Corporate bonds	**0.20bp**
SME Growth Market bonds	**0.15bp**
Government and municipal bonds	**0.10bp**
Cash	**Discount Rate per currency with a floor of 0**

50. In order to keep the levels relevant and effective and to allow for calibration and adaptation to changing market conditions and monitor the overall efficacy of the proposed measures, ESMA should be mandated to review the table of penalty rates on an ad hoc basis when market conditions are changing and provide an updated technical advice to the Commission.

51. For the sake of completeness, it is worth noting that ESMA also analysed an approach based on the TMPG applied for US treasuries at clearing level. Although, the model is designed to apply on trade consideration and not on mark-to-market value and lead to a zero penalty in case of low money market conditions, it was adapted, for the purpose of the analysis, to the circumstances of the penalty mechanism provided for by the Regulation. However, the approach was considered complex with results that risked being less predictable.

2.2 The increase or reduction of the basic amount of the penalty

52. In view of the mandate granted by the Commission, ESMA has considered circumstances where the basic penalty should be either increased or decreased. In this respect, due consideration was given to the draft RTS on penalties and the Commission suggestion to take into consideration the chain of interdependent transactions.

53. The mechanism provided for in the RTS on penalties, allows the full amount of the collected penalty to be redistributed to the suffering participant. This approach mitigates the impact of the penalty in a chain of interdependent transactions. If a participant is in the middle of a chain, it will receive the same amount as that it would pay as a penalty. While incentivising each intermediary in the chain to take action and cure the fail (as in this case it keeps the amount redistributed and is not charged with a penalty) this provides for a way to limit the negative effect the penalty because the amount received and paid are the same.

54. This approach also prevents negative impact on the risk profile of the CSD, trading venue or CCP and simplifies the implementation and management of the penalty mechanism as they only distribute what they collect.

55. A reduction or an increase of the penalties in different and various circumstances such as exceptional or repeated fails, would break the balance of the system described above and make more complex its implementation and management without bringing substantial additional benefits. Indeed, it is worth noting that, in view of the analysis of the current penalty systems that are applied, even though some provide for a possible increase in the penalty, such an increase is not applied and it was not considered efficient in order to further incentivise settlement discipline. Fails could result from different problems including technical difficulties.

56. For both the increase and decrease of the basic penalty amount, ESMA is of the view, as are most stakeholders, that at the first stage the system should be simple and that therefore no decrease or decrease should be used. At a second stage, depending on the

outcome of the penalty mechanism on settlement efficiency, it may be necessary to review the approach. It could then be assessed whether applying a reduction or an increase of the basic penalty mechanism would support further enhancement of the settlement efficiency. A process should therefore be foreseen for revision of the approach at a later stage.

57. In their answer to the DP, some stakeholders have raised the issue of the financial instruments that cannot be settled for reasons that are independent from the participants or CSDs. In such situations, they consider it unfair to be charged a penalty when they cannot take action in order to cure the settlement fail. ESMA understands that situation and proposes that in the limited circumstance where settlement cannot be performed for reasons that are independent from any of the participants or the CSD, the penalty would not be charged. In order to achieve that exception, it should be possible to reduce the amount of the penalty to zero. Examples of these occurrences may be a suspension of the instrument from trading and settlement due to reconciliation issues, specific corporate actions which imply the instrument no longer exists, or technical impossibilities at the CSD level. In order to prevent abuse, these exemptions should be approved by the Competent Authority, either through approval of the CSD procedures detailing in which specific cases penalties do not apply, or on a case by case basis.

2.3 Parameters for the calculation of cash penalties in the context of chains of interdependent transactions

58. In order to effectively reduce the number of failed instructions, and improve settlement efficiency in the Union, the focus of the penalty regime should be to disincentivise the original fails, which are the root cause of the issue. This is best achieved by designing a penalty mechanism where penalties are paid by the failing party and are received by the non-failing party. Such a mechanism should be effective in targeting participants which fail to deliver the securities on ISD, and which should be fully subject to the penalty, but should also immunize participants that are failing because they are being failed in turn, because the penalty due would be offset by the penalty received.

59. Redistributing penalties for an amount equivalent to that collected achieves the objective of addressing the issue of chain of interdependent transactions, whether visible or not, as requested in the mandate.

60. For this reason, it is important that the balance between the amount collected and distributed as proposed in the RTS be maintained, and be similar across the different structures involved in the penalty mechanism. As a result the parameters for the calculation of the penalties should not be modified in order to address the situation of chains of interdependent transactions.

3 Substantial Importance of a CSD

3.1 Introduction

13. Article 24(7) of Regulation (EU) No 909/2014 (CSDR) requires the European Commission (EC) to adopt delegated acts concerning measures for establishing the criteria under which the operations of a CSD in a host Member State could be considered *"of substantial importance for the functioning of the securities markets and the protection of the investors"* in that host Member State, in which case the competent authority of the home Member State and of the host Member State and the relevant authorities of the home Member State and of the host Member State shall establish cooperation arrangements for the supervision of the activities of that CSD in the host Member State.

14. On 2 October 2014 ESMA received a mandate to provide the EC with technical advice on this matter. The EC finds that the assessment of *substantial importance* needs to focus on the core CSD services (i.e. market infrastructure services) listed in Section A of the Annex to the CSDR (initial recording of securities in a book-entry system, central maintenance and settlement services, including securities and cash settlement provided by CSDs).

15. Therefore, the ancillary services listed in Sections B and C of that Annex that are not strictly speaking core market infrastructure services should not be considered beyond their complementary role to the core services to which they relate.

16. It is also the view of the EC that the assessment of the *substantial importance* should be done from the perspective of the host Member State and not from that of the CSD (i.e. a larger CSD may have limited non-substantial activities in a smaller Member State from the perspective of the CSD. Nevertheless, its service may be of *substantial importance* from the perspective of the host Member State).

17. ESMA's technical advice aims at assisting the EC in formulating a delegated act on the criteria to assess the *substantial importance* of the CSD's activities concerning the following three CSD core services and two related issues:

(a) Initial recording of securities in a book-entry system ('notary service');

(b) Providing and maintaining securities accounts at the top tier level ('central maintenance service');

(c) Operating a securities settlement system ('settlement service').

18. In addition, these three core services need to be considered also in the following situations:

(a) Market consolidation affecting host Member States; and

(b) Branching into host Member States.

3.2 Consultation Paper Feedback Statement

Frequency of the assessment of substantial importance

19. There was broad support for the proposed frequency of one year for the assessment of the substantial importance of a CSD in another Member State.

Proposed Indicators

20. Several respondents mentioned that substantial importance should be limited to the cases where the CSD has set up a branch in another Member State or provides notary and/or central maintenance services in another Member State. In their view, this would be in line with the notion of provision of services under Article 23 (freedom to provide services) of CSDR. In other words, they consider that "settlement indicators" are not appropriate, as there would be an inconsistency between Article 23 and 24 of Level 1.

21. The Commission mandate on ESMA technical advice in this field has identified central maintenance and settlement services as being included in the scope of the delegated act: *"It is the view of the Commission services that the assessment of substantial importance needs to focus on the core CSD services (i.e. market infrastructure services) listed in Section A of the Annex to the CSDR (initial recording of securities in a book-entry system, central maintenance and settlement services, including securities and cash settlement provided by CSDs)*". According to Article 23(1) of CSDR, an authorised CSD may provide services referred to in the Annex within the territory of the Union, including through setting up a branch, provided that those services are covered by the authorisation. Therefore, in ESMA's opinion, Article 23 is not limited only to the setting up of a branch or the provision of notary and/or central maintenance services in another Member State. What Article 23(2) does is to specify a procedure to be used in case an authorised CSD intends to provide the core services referred to in points 1 and 2 of Section A of the Annex in relation to financial instruments constituted under the law of another Member State referred to in Article 49(1) or to set up a branch in another Member State. In ESMA's opinion, this does not mean that, if a CSD wants to provide other services under Article 23, it would not be able to do it. Therefore, in line with the mandate received from the Commission, ESMA proposes to cover settlement indicators as part of the assessment of substantial importance of a CSD.

22. Several respondents did not agree that the participants of the host Member State are an adequate proxy for the investors. According to them, the nationality of the CSD participant is largely irrelevant for the measurement of the protection of the investors because it is perfectly possible and a market reality that participants hold securities for foreign end investors. It is recognised that the CSDs have no information on the country of their participant's clients, but this limitation should not be the reason for the use of an inaccurate threshold. Therefore they proposed that the central maintenance indicator should be reviewed.

23. ESMA is aware of the limitations of using the participants of the host Member State as a proxy for the investors in the Member State. However, to the extent that a CSD does not have the necessary information on the indirect provision of settlement services (i.e. to indirect participants or to the end investors) and that it would be problematic to compute such a calculation, ESMA believes participants can be a proxy for investors.

24. Several respondents noticed that the CSDs are unable to calculate the denominator of the proposed indicators and considered that ESMA would have to consolidate the data from all relevant CSDs across the EU in order to calculate the indicators.

25. Given the need to use consistent data at EU level for the calculation of the indicators, ESMA may consider issuing Guidelines further specifying the process for the collection and calculation of the indicators.

26. Several respondents considered the notary service indicator as appropriate.

27. Several respondents supported the decision of ESMA not to include collateral management services in the assessment of the central maintenance indicator.

28. Two respondents highlighted that the resulting cooperation arrangements and agreed supervisory practices should not lead to further administrative and compliance burdens for CSDs. The latter might discourage CSDs from providing services in other countries which is in contradiction with the policy objective of CSDR.

29. One respondent highlighted that the thresholds would have to be calculated before the launch of the authorisation process, otherwise it would be unclear which authorities need to get involved in the authorisation process.

30. Given that it would take time for the CSDs to implement the necessary record keeping requirements and IT processes to enable them to collect and to filter data based on the proposed indicators for substantial importance, ESMA believes it should be possible to only consider the Issuers' perspective for the notary and/or central maintenance services, as well as the settlement service indicator referring to the law governing the securities settlement system operated by the CSD, under Article 24(4) of Regulation (EU) No 909/2014, in the context of the authorisation to provide banking-type ancillary services based on Article 55(4)(d) of Regulation (EU) No 909/2014. A simulation exercise conducted by ESMA has shown that CSDs are currently only able to provide information on the notary and/or central maintenance indicator from an issuer perspective. At the same time, the law governing the securities settlement system operated by a CSD is information that is publicly available under the Settlement Finality Directive. Following the authorisation of CSDs and the collection of the relevant data by CSDs, the indicators for substantial importance should be recalculated on the basis of all indicators.

31. One respondent considered that the central maintenance service indicator should not refer to the participants' location because contrary to other account maintenance services, the central maintenance service should consider the jurisdiction of the issuer or issuer's agent as an involvement of the latter is needed before a CSD can provide accounts at top tier level. Otherwise there would be no distinction between central maintenance services and other maintenance services.

32. ESMA believes that central maintenance services mirror to a large extent the issuance services (i.e. a CSD responsible for the issuance of a given security is also normally responsible for the maintenance of the relevant securities accounts at the top tier level). However, in order to cater for different models where the notary and central maintenance services are not both provided by a CSD, ESMA suggests that a joint indicator based on the Issuers' perspective should be used, referring to the home jurisdiction of the issuer which has issued the security that is initially recorded and/or centrally maintained by the CSD.

33. ESMA notes that the core service according to Annex A of Regulation (EU) No 909/2014 is providing and maintaining securities accounts at the top tier level, which describes the central maintenance service provided by Issuer CSDs. Nonetheless, it has also considered the possibility of capturing maintenance (maintaining securities accounts not at top tier level) in addition to central maintenance, in order to also capture the Investor CSD activity. However, ESMA believes that this activity may partially be captured under the settlement indicator to the extent that securities are actively traded and settled. Therefore ESMA proposes not to include this.

34. One respondent remarked that it would also be possible that securities have a dual primary listing, and suggested the that the wording "*the trading venue where the securities were first admitted to trading*" should be clarified.

35. ESMA proposes that, where referred to in the proposed indicators, the calculation of the market value should be based on the following, as verified during the preceding year:

    a) for financial instruments admitted to trading on an EU trading venue, the value determined on the basis of the reference price of the trading venue where the financial instruments were first admitted to trading, or of the most relevant market in terms of liquidity, as follows:

    i. for the financial instruments referred to in Article 3(1) of Regulation (EU) No 600/2014 [shares, depositary receipts, ETFs, certificates and other similar financial instruments], the most relevant market in terms of liquidity as referred to in Article 4(6)(b) of Regulation (EU) No 600/2014;

    ii. for other financial instruments than those referred to in point i), the trading venue with the highest turnover within the Union for the specific financial instrument;

    b) for other financial instruments than those referred to in point a), the value determined on the basis of the reference price calculated using a pre-determined methodology referring as much as possible to criteria related to the markets data such as market prices available across trading venues or investment firms.

Proposed Thresholds

36. Several respondents welcomed the suggestion of ESMA to undertake a simulation exercise before the draft technical advice is finalised in order to address the number of authorities that would be required to establish cooperation arrangements.

37. Several respondents agreed with the proposed 15% thresholds, while one respondent was in favour of higher thresholds (i.e. 25%) in order not to end up with largely attended "colleges".

38. Having regard to the CP feedback and to the results of the simulation exercise run by ESMA through ECSDA, ESMA proposes to keep the 15% thresholds.

Relevance of the proposed indicators and thresholds for government bonds

39. Several respondents did not see a reason why there should be different thresholds for government bonds, while one respondent was in favour of a special treatment in case the majority of an EU Member State's government bonds are issued through a single CSD.

40. Having regard to the CP feedback, ESMA proposes not to have a special treatment for one (or more) specific asset types, as this would increase the number of indicators which in turn would increase the complexity of the calculations and the burden for the authorities.

3.3 Overview of the Technical Advice on Substantial Importance of a CSD

41. As general principles, the number of indicators, the respective thresholds and the frequency for assessments should be defined in a way to: (i) capture CSDs of **substantial** importance with respect to core services offered to host Member States (ii) allow for a **practical and straightforward indicator based framework** to be regularly assessed by competent authorities (iii) **avoid an over-excessive number of cooperation arrangements** and ultimately **ensure an efficient and effective supervision/oversight** of CSDs/SSSs.

42. Each indicator is linked to a core service.

43. Each indicator is to be looked at separately. That is to say that if the result of the calculation in any of the indicators is above the predefined threshold, this will indicate that the measured activity of a home CSD is substantially important in the host Member State.

44. The determination of the thresholds is of utmost importance. The thresholds should be defined in a way as to solely capture CSDs of **substantial** importance for the host Member State. By doing so, the establishment of an over-excessive number of cooperative arrangements, potentially impacting the efficient and effective supervision/oversight of CSDs/SSSs should be avoided.

45. Where referred to in the proposed indicators, the calculation of the market value should be based on the following, as verified during the preceding year:

    a) for financial instruments admitted to trading on an EU trading venue, the value determined on the basis of the reference price of the trading venue where the financial instruments were first admitted to trading, or of the most relevant market in terms of liquidity, as follows:

        i. for the financial instruments referred to in Article 3(1) of Regulation (EU) No 600/2014 [shares, depositary receipts, ETFs, certificates and other similar financial instruments], the most relevant market in terms of liquidity as referred to in Article 4(6)(b) of Regulation (EU) No 600/2014;

        ii. for other financial instruments than those referred to in point i), the trading venue with the highest turnover within the Union for the specific financial instrument;

    b) for other financial instruments than those referred to in point a), the value determined on the basis of the reference price calculated using a pre-determined methodology referring as much as possible to criteria related to the markets data such as market prices available across trading venues or investment firms.

46. The competent authority of the host Member State should apply the indicators set out in this technical advice and assess substantial importance every year. This frequency is being proposed for practical reasons, given that the data required for the calculation of the indicators is quite extensive, involving aggregation at EU level.

47. If a threshold for substantial importance is reached, the relevant cooperative arrangement that is triggered should last at least for 3 years.

48. Given that it would take time for the CSDs to implement the necessary record keeping requirements and IT processes to enable them to collect and to filter data based on the proposed indicators for substantial importance, ESMA believes it should be possible to only consider the Issuers' perspective for the notary and/or central maintenance services, as well as the settlement service indicator referring to the law governing the securities settlement system operated by the CSD, under Article 24(4) of Regulation (EU) No 909/2014, in the context of the authorisation to provide banking-type ancillary services based on Article 55(4)(d) of Regulation (EU) No 909/2014. A simulation exercise conducted by ESMA has shown that CSDs are currently only able to provide information on the notary and/or central maintenance indicator from an issuer perspective. At the same time, the law governing the securities settlement system operated by a CSD is information that is publicly available under the Settlement Finality Directive. Following the authorisation of CSDs and the collection of the relevant data by CSDs, the indicators for substantial importance should be recalculated on the basis of all indicators.

3.4 Assessment of the 'substantial importance' of notary services and/or central maintenance services: issuers' perspective

3.4.1 Scope of financial instruments to be included

49. ESMA has considered whether the assessment should cover all financial instruments issued by host Member State issuers, and concludes that all instruments where possible should be covered in order to include the full spectrum of issued securities.

50. ESMA has considered whether the assessment should capture the law that governs a financial instrument. Since issuers may opt to issue in a particular jurisdiction depending on their targeted investors and/or type of instruments, it does not seem appropriate to focus on instruments that are governed by a certain law, as this may not capture the full extent of the notary and/or central maintenance services by a CSD in a host Member State.

51. In addition, since issuers may opt to issue securities in jurisdictions other than their principal place of incorporation, ESMA proposes the use of a criterion linked with the jurisdiction where the issuer is incorporated.

52. Central maintenance services mirror to a large extent the issuance services (i.e. a CSD responsible for the issuance of a given security is also normally responsible for the maintenance of the relevant securities accounts at the top tier level). However, in order to cater for different models where the notary and central maintenance services are not both provided by a CSD, ESMA suggests that a joint indicator based on the Issuers' perspective should be used, referring to the home jurisdiction of the issuer which has issued the security that is initially recorded and/or centrally maintained by the CSD.

3.4.2 Criteria to assess the substantial importance of notary services and/or central maintenance services from the issuers' perspective

Notary Service and Central Maintenance Service – Issuers' Perspective Indicator - proposed threshold: 15%

Numerator: Market value or, if not available, nominal value of *securities issued by issuers* from the host Member State *initially recorded* in or centrally maintained by the CSD of the home Member State

Denominator: Total market value or, if not available, nominal value of *securities issued by issuers* from the host Member State *initially recorded* in or centrally maintained by all CSDs established in the European Union, including in or by central banks acting as CSDs.

3.5 Assessment of the 'substantial importance' of central maintenance services: participants' perspective

3.5.1 Scope of financial instruments to be included

53. In addition to the joint criterion for the notary service and/or the central maintenance service based on the issuers' perspective, ESMA proposes that the central maintenance service is also assessed using data from the participant angle. ESMA notes however that the reference to the home jurisdiction of the participant which holds the security at top tier level will not achieve a fully accurate representation of the investor side. Nevertheless, to the extent that a CSD does not have the necessary information on the indirect provision of central maintenance services (i.e. to indirect participants or to the end investors) and that it would be problematic to compute such a calculation, participants of the host Member State would be a proxy for investors and should help ensure there is consideration of the protection of investors in the host Member State.

54. It should also be noted that CSDs that use the direct holding model do not necessarily have participants that hold securities in the securities settlement system operated by the CSD. Therefore, we propose to refer also to other holders of securities accounts in the securities settlement system operated by the CSD of the home Member State.

3.5.2 Central maintenance versus maintenance

55. ESMA notes that the core service according to Annex A of Regulation (EU) No 909/2014 is providing and maintaining securities accounts at the top tier level, which describes the central maintenance service provided by Issuer CSDs. Nonetheless, it has also considered the possibility of capturing maintenance (maintaining securities accounts not at top tier level) in addition to central maintenance, in order to also capture the Investor CSD activity. However, ESMA believes that this activity may partially be captured under the settlement indicator to the extent that securities are actively traded and settled. Therefore ESMA proposes not to include this.

3.5.3 Collateral management services

56. ESMA has considered whether, in addition to central maintenance services, it would be important to consider ancillary services that complement this service, such as collateral management services. A majority of the collateral management services would already be captured in the scope of the settlement services and therefore the substantial importance criteria for settlement services would reflect this. However, there would be instances where this service would not be covered by settlement service for example, where a pledge has been made. At the same time, collateral management services can also be provided by other entities than CSDs (such as custodians, investment firms, etc.).Therefore, ESMA proposes not to include collateral management services.

3.5.4 Criteria to assess the substantial importance of central maintenance services

Central Maintenance – Participants' Perspective Indicator - proposed threshold: 15%

Numerator: Market value or, if not available, nominal value of *securities centrally maintained* by the CSD of the home Member State *for participants and other holders of securities accounts* of the host Member State

Denominator: Total market value or, if not available, nominal value of *securities centrally maintained* by all CSDs established in the European Union, including by central banks acting as CSDs, *for participants and other holders of securities accounts* of the host Member State

3.6 Assessment of the 'substantial importance' of settlement services

3.6.1 Consideration of settlement services from the perspective of the Issuers

57. ESMA has considered whether the settlement services should be assessed from the perspective of the issuers. The settlement activities of a CSD from a home Member State may be of substantial importance for the functioning of the securities markets from another Member State if the CSD from the home Member State settles a significant amount of securities issued by issuers from the host Member State. In such a case if the settlement is not functioning smoothly or the CSD is not properly supervised, the confidence and the efficiency of the securities market of the host Member State would be at risk.

58. This indicator has the additional advantage of covering not only issuer CSD activities, but also investor CSD activities better than the participants' perspective indicator mentioned below, because a CSD can be an investor CSD without necessarily having any relationship with participants from another Member State. This may happen when a CSD from a home Member State (investor CSD) has a link with a CSD from the host Member State (issuer CSD). In this case, the investor CSD is not providing any settlement services to other participants in the SSS of the issuer CSD (the activity of the investor CSD is not covered by the participants' perspective indicator mentioned below); nevertheless, the investor CSD settles the securities issued by the issuer CSD.

3.6.2 Consideration of settlement services from the perspective of participants to a CSD

59. ESMA has considered whether the settlement services should be assessed from the perspective of the participants in a securities settlement system operated by a CSD. It is ESMA's view that this approach would allow for the investor CSD activity to be captured and would therefore provide an accurate representation of whether the activity is substantially important.

60. To the extent that a CSD does not have the necessary information on the indirect provision of settlement services (i.e. to indirect participants or to the end investors) and that it would be problematic to compute such a calculation, participants of the host Member State would be a proxy for investors and should help ensure there is consideration of the protection of investors in the host Member State.

3.6.3 Law governing the securities settlement system operated by a CSD

61. ESMA believes that if a CSD operates a securities settlement system governed by the law of another Member State, that CSD should be considered as substantially important for the functioning of the securities markets and the protection of the investors in that host Member State.

3.6.4 Criteria to assess the substantial importance of the settlement services

1. Settlement Service – Issuers' Perspective Indicator - proposed threshold: 15%

Numerator: Value of the *settlement instructions that have a cash leg* plus the market value of the *FOP settlement instructions* or, if not available, the nominal value of the *FOP settlement instructions settled* by the CSD of the home Member State in relation to transactions in *securities issued by issuers from the host Member State*

Denominator: Total value of the *settlement instructions that have a cash leg* plus the total market value of the *FOP settlement instructions* or, if not available, the nominal value of the *FOP settlement instructions settled* by all CSDs established in the European Union, including by central banks acting as CSDs, in relation to transactions in *securities issued by issuers from the host Member State*

2. Settlement Service – Participants' Perspective Indicator - proposed threshold: 15%

Numerator: Value of the *settlement instructions that have a cash leg* plus the market value of the *FOP settlement instructions* or, if not available, the nominal value of the *FOP settlement instructions settled* by the CSD of the home Member State *from participants as well as for other holders of securities accounts of the host Member State*

Denominator: Total value of the *settlement instructions that have a cash leg* plus the total market value of the *FOP settlement instructions* or, if not available, the nominal value of the *FOP settlement instructions settled* by all CSDs established in the European Union, including by central banks acting as CSDs, *from participants as well as for other holders of securities accounts of the host Member State*

3. Settlement Service – Law Governing the Securities Settlement System Indicator

If a CSD operates a securities settlement system governed by the law of another Member State, that CSD is considered as substantially important for the functioning of the securities markets and the protection of the investors in that host Member State,

3.7 Market consolidation affecting host Member States

3.7.1 Reflections on how to apply/adapt the criteria above for assessing the substantial importance where a host Member State no longer has a 'local' CSD

62. In the event where a host Member State's "local" CSD is subject to market consolidation (e.g. through mergers, takeovers, or other types of business transfers), the respective core CSD services will provided by one or more CSDs of (an)other country/countries. This would result in two scenarios:

a) The core services of the local CSD are predominantly taken over by one (or a limited number of) other CSD(s) (e.g. through a merger, take-over). In this case the criteria for assessing substantial importance for the core services would duly show that the other CSD(s) has/have become of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State (i.e. where the "local" CSD was established). Indeed the host Member State will substantially rely on the activities of such CSD(s) and thus a cooperation arrangement between the home and host Member States' competent authorities is warranted.

b) The core services of the local CSD are transferred to a large number of other CSD(s) or custodians (e.g. activities are partly or fully transferred by respective participants/issuers to a high number of other CSDs or custodians because e.g. of increased competition). In this case the criteria for assessing substantial importance for the core services may not (at least for an individual CSD) exceed the suggested thresholds, as each of these CSDs would not necessarily be of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State. In this situation, the activities, and thus the risks for the host securities markets and investors, would not be concentrated in a specific CSD but spread among a large number of CSDs or custodians. The host securities markets would thus not substantially rely on a specific CSD and alternative CSDs would be available should one of the CSDs/custodians stop offering services in that host Member State. In such cases, the information exchange foreseen in the CSDR would provide the host authorities with adequate information on the activities of the respective CSDs in the host Member State and specific cooperation arrangements are not warranted. Therefore no specific criteria would be required.

3.7.2 Criteria to assess substantial importance in the event of market consolidation

63. ESMA concludes that no additional criterion is necessary to assess substantial importance in the event of market consolidation. The proposed criteria to assess substantial importance of notary services, central maintenance services and settlement services are sufficient as they will take into account any major market consolidations in the host Member State and would capture any need to have dedicated co-operation arrangements with another competent authority.

3.7.3 Establishing branches into host Member States - Reflections on how to apply/adapt the criteria above for assessing the substantial importance in the context of branching

64. Whilst establishing a branch in a host Member State and having a physical presence indicates the willingness of developing in a certain market, the activity of the CSD in a host Member State may not necessarily be of substantial importance, despite the fact that a branch is established. There is no guarantee that having a branch will lead to significant activity. As a consequence, the establishment of a branch should not be a standalone separate criterion in demonstrating substantial importance. In the event that the branch does generate significant activity of a CSD in the host Member State and it is substantially important, this will be adequately captured under one (or more) of the indicators relating to the core services.

65. ESMA concludes that no additional criteria are necessary to assess substantial importance in the context of the establishment of branches. The proposed criteria to assess substantial importance of notary services, central maintenance services and settlement services would adequately capture the need for the competent authorities to have co-operation arrangements, if the activity of a CSD does become of substantial importance.

3.8 Additional considerations

66. This section has the aim to draw the attention on certain aspects which have been taken into account when defining the criteria for the measurement of the substantial importance of a CSD for a host Member State.

3.8.1 Specialisation of a CSD in a specific type of financial instrument and/or in a specific type of securities transaction

67. In case a CSD concentrates its activities on a specific type of financial instrument and/or specific type of securities transaction, the CSD may be of importance for this specific type of financial instrument and/or type of securities transaction at European Union level as well as at national level.

68. However, the fact that a CSD may be of importance for a specific type of financial instrument and/or type of securities transaction with respect to the securities markets or investors of the host Member State would not automatically mean that the CSD is of substantial importance for securities markets or investors of the host Member State in general. For instance in case a CSD is specialised in the initial recording, central maintenance and/or settlement of one specific type of financial instrument and/or type of securities transaction but this type of financial instrument [and/or type of securities transaction] only represents a minor part of the initial recording, central maintenance or settlement activity of that host Member State, the CSD should not be considered as substantially important for the securities market and/or investors of the host Member State.

69. Having this in mind, and considering the need to ensure a practical and efficient framework in line with the general principles described in section 1, it is proposed to evaluate the substantial importance of a CSD with respect to the functioning of the securities markets and protection of the investors of a host Member State on a global basis and thus not to split the above indicators per type of instrument or per type of transaction. Such a split would indeed significantly multiply the number of indicators that would need to be collected and regularly assessed by competent authorities and lead to a complex and unmanageable process.

3.8.2 Scope of the securities markets

70. ESMA notes that some of the considered services are not exclusively provided by CSDs but also by other entities and that for certain types of financial instruments and/or types of securities transactions, the entire services are, to a large extent, provided by other entities than CSDs. This has an impact on measuring the substantial importance of a CSD with respect to a specific securities market and has as consequence that the reference to securities market as proposed in the indicators does not represent the entire securities market of the European Union (i.e. the denominator does not represent the total activity in the securities market of a Member State). This is particularly the case for the settlement related indicators due to settlement internalisation.

71. Despite the above limitations, it is of the utmost importance that the indicators suggested in this Technical Advice appropriately balance the need to keep the framework simple and manageable. In this respect, ESMA considers that the proposed indicators will allow for an appropriate assessment of the substantial importance of the CSDs established in the European Union with respect to the securities market and investors of a specific host Member State.

3.9 Summary of the proposed indicators

72. The criteria by which the operations of a CSD in a host Member State could be considered of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State are:

Notary Service

1) Notary Service and Central Maintenance Service – Issuers' Perspective Indicator - proposed threshold: 15%

Numerator: Market value or, if not available, nominal value of *securities issued by issuers* from the host Member State *initially recorded in or centrally maintained* by the CSD of the home Member State

Denominator: Total market value or, if not available, nominal value of *securities issued by issuers* from the host Member State *initially recorded in or centrally maintained* by all CSDs established in the European Union, including in or by central banks acting as CSDs.

Central Maintenance Service

2) Central Maintenance – Participants' Perspective Indicator - proposed threshold: 15%

Numerator: Market value or, if not available, nominal value of *securities centrally maintained* by the CSD of the home Member State *for participants and other holders of securities accounts* of the host Member State

Denominator: Total market value or, if not available, nominal value of *securities centrally maintained* by all CSDs established in the European Union, including by central banks acting as CSDs, *for participants and other holders of securities accounts* of the host Member State

Settlement Service

3) Settlement Service – Issuers' Perspective Indicator - proposed threshold: 15%

Numerator: Value of the *settlement instructions that have a cash leg* plus the market value of the *FOP settlement instructions* or, if not available, the nominal value of the *FOP settlement instructions settled* by the CSD of the home Member State in relation to transactions in *securities issued by issuers from the host Member State*

Denominator: Total value of the *settlement instructions that have a cash leg* plus the total market value of the *FOP settlement instructions* or, if not available, the nominal value of the

FOP settlement instructions settled by all CSDs established in the European Union, including by central banks acting as CSDs, in relation to transactions in *securities issued by issuers from the host Member State*

4) Settlement Service – Participants' Perspective Indicator - proposed threshold: 15%

Numerator: Value of the *settlement instructions that have a cash leg* plus the market value of the *FOP settlement instructions* or, if not available, the nominal value of the *FOP settlement instructions settled* by the CSD of the home Member State *from participants as well as for other holders of securities accounts of the host Member State*

Denominator: Total value of the *settlement instructions that have a cash leg* plus the total market value of the *FOP settlement instructions* or, if not available, the nominal value of the *FOP settlement instructions settled* by all CSDs established in the European Union, including by central banks acting as CSDs, *from participants as well as for other holders of securities accounts of the host Member State*

5) Settlement Service – Law Governing the Securities Settlement System Indicator

If a CSD operates a securities settlement system governed by the law of another Member State, that CSD is considered as substantially important for the functioning of the securities markets and the protection of the investors in that host Member State.

Annex I - EC mandate regarding technical advice on the level of penalties for settlement fails

PROVISIONAL[2] REQUEST TO ESMA FOR TECHNICAL ADVICE ON POSSIBLE DELEGATED ACTS CONCERNING CERTAIN SETTLEMENT DISCIPLINE MEASURES

With this mandate, the Commission seeks ESMA's technical advice on possible delegated acts concerning the Regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) ('CSDR' or the "**legislative act**"). These delegated acts should be adopted in accordance with Article 290 of the Treaty on the Functioning of the European Union (TFEU).

The provisional nature of the present mandate stems from the fact that the CSDR has not yet entered into force. However, the Council (at the meeting of COREPER on 24 February) and the European Parliament (by a vote in the Plenary Session on 25 April) have approved the CSDR text. Currently, CSDR is subject to legal revision and translation prior to its publication in the EU Official Journal.

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

The mandate follows the Regulation of the European Parliament and the Council establishing a European Securities and Markets Authority (the "**ESMA Regulation**"),[3] 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**"),[4] and the Framework Agreement on Relations between the European Parliament and the European Commission (the "**Framework Agreement**").[5]

According to Articles 7(13) of CSDR, the Commission shall adopt delegated acts to specify the parameters for the calculation of cash penalties to be imposed by CSDs for settlement fails.

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The European Parliament and the Council shall be duly informed about this mandate.

In accordance with the 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,[6] 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

[2] On 2 October 2014, following the publication of the CSDR in the OJ and its entry into force, ESMA received the confirmation from the EC that this mandate should no longer be considered as provisional but as final. (http://www.esma.europa.eu/system/files/20141002_esma_-_csdr_mandates.pdf)
[3] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), OJ L 331, 84 15.12.2010.
[4] Communication of 9.12.2009. COM (2009) 673 final.
[5] OJ L304/47, 20.11.2010, p. 47-62.
[6] Commission's Decision of 6.6.2001 establishing the European Securities Committee, OJ L191, 17.7.2001, p.45-46.

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 68 of CSDR. As soon as the Commission adopts a possible delegated act, the Commission will notify it simultaneously to the European Parliament and the Council.

1. Context

1.1 Scope

One of the objectives of CSDR is to improve settlement efficiency in the Union. To achieve this objective, Article 7 of CSDR provides for a set of strict measures to address settlement fails. In particular, any participant to a securities settlement system operated by a CSD, party to a transaction, that fails to deliver the relevant financial instruments on the agreed settlement date will be subject to cash penalties that will be collected by CSDs and a buy-in procedure whereby those securities shall be bought and delivered in a timely manner to the receiving counterparty. While most of technical details of the operation of the settlement discipline measures will be further specified in the future regulatory technical standards, Article 7(13) of CSDR requires the Commission to adopt a delegated act to specify the parameters for the calculation of a deterrent and proportionate level of cash penalties for settlement fails. This provision states also that the level of cash penalties should take into account the asset type, liquidity of the financial instruments and the type of the transactions concerned and should ensure a high degree of settlement discipline and a smooth functioning of the financial markets concerned.

This mandate focuses on the technical aspects of a delegated act on cash penalties. In providing its advice, ESMA should build upon its own experience and upon that of national authorities concerning settlement discipline measures already in place.

1.2 Principles that ESMA should take into account

ESMA is invited to take account of the following principles:

- It should respect the requirements of the ESMA Regulation, and, to the extent that ESMA takes over the tasks of CESR in accordance with Art 8(1)(l) of the ESMA Regulation, take account of the principles set out in the Lamfalussy Report[7] and those mentioned in the Stockholm Resolution of 23 March 2001[8].

- The principle of proportionality: the technical advice should not go beyond what is necessary to achieve the objective of the delegated act set out in the legislative act.

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

[7] Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, chaired by M. Lamfalussy, Brussels, 15 February 2001. (http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf)

[8] Results of the Council of Economics and Finance Ministers, 22 March 2001, Stockholm Securities legislation, (http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/01/105&format=HTML&aged=0&language=EN&guiLanguage=en).

- In accordance with the ESMA Regulation, ESMA should not feel confined in its reflection to elements that it considers should be addressed by the delegated act but, if it finds it appropriate, it may indicate guidelines and recommendations that it believes should accompany the delegated act to better ensure its effectiveness.

- ESMA determines its own working methods depending on the content of the various aspects 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 is invited to widely consult market participants in an open and transparent manner. ESMA should provide advice which takes account of different opinions expressed by the market participants during their consultation. ESMA's technical advice should include a feedback statement on the consultation justifying its choices vis-à-vis the main arguments raised during the consultation.

- ESMA is invited to support its advice by providing a cost-benefit analysis of all the options considered and proposed.

- The technical advice should contain sufficient and detailed explanations for the assessment done, and be presented in an easily understandable language respecting current legal terminology at European level.

- ESMA should provide comprehensive technical analysis on the subject matters described below covered by the delegated powers and included in the relevant provision of the legislative act, in the corresponding recitals as well as in the relevant Commission's request included in this mandate.

- The technical advice given by ESMA to the Commission should not take the form of a legal text. However, ESMA should provide the Commission with an "articulated" text which means a clear and structured text, accompanied by sufficient and detailed explanations for the advice given, and which is presented in an easily understandable language respecting current terminology in the Union.

- ESMA should address to the Commission any question it might have concerning the clarification on the text of the legislative act, which it considers of relevance to the preparation of its technical advice.

2 Procedure

The Commission is requesting the technical advice of ESMA in view of the preparation of a delegated act to be adopted pursuant to the legislative act and in particular regarding the questions referred to in section 3 of this formal mandate.

This mandate takes into account the ESMA Regulation, the 290 Communication and the Framework Agreement.

The Commission reserves the right to revise and/or supplement this formal 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 delegated acts relating to the legislative act and will keep ESMA informed of progress made.

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

3. Mandate for technical advice

3.1 Preliminary remarks

Article 7(2) provides that CSDs should put in place a penalty mechanism which serves as an effective deterrent for participants that cause settlement fails. Such a penalty mechanism does not apply to failing participants which are CCPs and should include cash penalties that should be calculated on a daily basis for each business day following the settlement fail until the actual settlement date or any other factor terminating the transaction.

It is the view of the Commission services that only a cash penalty with a variable component (ad valorem penalty) that takes into account the value(s) of the transaction(s) that fail to be settled will be able to achieve the required deterrence and proportionality of the penalty[9]. The Commission services consider that the application of cash penalties should be subject to parameters that are simple enough to be applied via an automated system, given the high volumes of settlement instructions. However, CSDs should also be able to increase or decrease the cash penalty that they would normally charge (basic amount) in order to take account of the actual behaviour of non-compliant participants (e.g. repeated non-compliant behaviour).

3.2 Content of the technical advice

ESMA is invited to provide technical advice to assist the Commission in formulating a delegated act on cash penalties, and more specifically on the following aspects:

(a) the parameters for calculating the cash penalty that a CSD will normally charge for settlement fails (i.e. the basic amount of a cash penalty);

(b) the circumstances that may justify an increase of the basic amount of the cash penalty and the parameters for the calculation of such an increase, whilst applicable under an automated system;

(c) the circumstances that may justify a reduction of the basic amount of the cash penalty and the parameters for the calculation of such a reduction whilst applicable under an automated system; and

(d) how to adapt the parameters for the calculation of cash penalties in the context of a chain of interdependent transactions and whether there are cases where this would not be possible (e.g. the chain would not be visible).

3.2.1 The parameters for the calculation of the basic amount of a cash penalty

[9] A fixed cash penalty may be either too small for a high value transaction or too big for a small value transaction

- ESMA is invited to reflect on the parameters for the calculation of the basic amount of cash penalties that CSDs will charge by taking into account the following policy principles:

    - The variable component of a cash penalty should relate to the value(s) of the transaction(s) that fail to settle;

    - The principle that CSDR is neutral as regards the existing securities holding models (the parameters of the calculation of the basic amount of the cash penalty should not put at a significant disadvantage a given securities holding model);

    - The cash penalty should be deterrent to ensure a high degree of settlement efficiency (improve to the extent possible the existing levels of settlement efficiency);

    - The cash penalty should be proportionate and take into account the specificities of different asset types, the degree of liquidity, and the types of transactions concerned.

3.2.2. The circumstances that justify an increase of the basic amount

- In order to ensure a high degree of deterrence, the cash penalty needs to be increased in situations where the basic amount proves to be insufficient to change the non-compliant behaviour of a CSD participant. ESMA is invited to reflect on:

    - The circumstances in which an increase of the basic amount of the cash penalty is justified (e.g. repeated non-compliant behaviour; continuous underperformance of a CSD participant with regard to settlement discipline; refusal to cooperate by a CSD participant with a view to improving settlement discipline);

    - The parameters of the calculation of an increase of the basic amount of a cash penalty by taking into account the principles of deterrence and proportionality.

3.2.3. The circumstances that justify a reduction of the basic amount

- In order to guarantee the proportionality of the cash penalty, the cash penalty needs to take account of the circumstances that may mitigate the non-compliant behaviour of a market participant. ESMA is invited to reflect on:

    - The circumstances in which a reduction of the basic amount of the cash penalty is justified.

    - The parameters of the calculation of a reduction of the basic amount of a cash penalty by taking into account the principles of deterrence and proportionality.

3.2.4. Chain of interdependent transactions

- ESMA is invited to reflect on how to adapt the parameters for calculating/allocating the payment of the basic amount of cash penalties in the context of a chain of

interdependent transactions. In this regard, ESMA should consider cases where chains of interdependent transactions are not visible.

4. 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 delegated acts according to Article 290 of the TFEU. The powers of the Commission to adopt delegated acts are subject to Article 68 of the legislative act which allows the European Parliament and the Council to object to a delegated act within a period of 3 months, extendible by 3 further months. The delegated act will only enter into force if neither European Parliament nor the Council has objected on expiry of that period or if both institutions have informed the Commission of their intention not to raise objections.

The deadline set to ESMA to deliver the technical advice is nine months after the entry into force of CSDR.

Annex II – EC mandate regarding technical advice on the substantial importance of a CSD

PROVISIONAL[10] REQUEST TO ESMA FOR TECHNICAL ADVICE ON POSSIBLE DELEGATED ACTS CONCERNING CERTAIN ASPECTS RELATED TO THE COOPERATION OF COMPETENT AUTHORITIES IN THE SUPERVISION OF CSDs

With this mandate, the Commission seeks ESMA's technical advice on possible delegated acts concerning the Regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) ('CSDR' or the "**legislative act**"). These delegated acts should be adopted in accordance with Article 290 of the Treaty on the Functioning of the European Union (TFEU).

The provisional nature of the present mandate stems from the fact that the CSDR has not yet entered into force. However, the Council (at the meeting of COREPER on 24 February) and the European Parliament (by a vote in the Plenary Session on 25 April) have approved the CSDR text. Currently, CSDR is subject to legal revision and translation prior to its publication in the EU Official Journal.

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

The mandate follows the Regulation of the European Parliament and the Council establishing a European Securities and Markets Authority (the "**ESMA Regulation**"),[11] 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**"), [12] and the Framework Agreement on Relations between the European Parliament and the European Commission (the "**Framework Agreement**").[13]

According to Article 24(7) of CSDR, the Commission shall adopt delegated acts concerning measures to establish the criteria under which the operations of a CSD in a host Member State could be considered of *substantial importance* for the functioning of the securities markets and the protection of the investors in that host Member State.

***

The European Parliament and the Council shall be duly informed about this mandate.

In accordance with the 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,[14] 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.

[10] On 2 October 2014, following the publication of the CSDR in the OJ and its entry into force, ESMA received the confirmation from the EC that this mandate should no longer be considered as provisional but as final. (http://www.esma.europa.eu/system/files/20141002_esma_-_csdr_mandates.pdf)
[11] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), OJ L 331, 84 15.12.2010.
[12] Communication of 9.12.2009. COM (2009) 673 final.
[13] OJ L304/47, 20.11.2010, p. 47-62.
[14] Commission's Decision of 6.6.2001 establishing the European Securities Committee, OJ L191, 17.7.2001, p.45-46.

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 68 of CSDR. As soon as the Commission adopts a possible delegated act, the Commission will notify it simultaneously to the European Parliament and the Council.

1. Context

1.1 Scope

One of the objectives of CSDR is to create an internal market for CSD services. To achieve this objective, Article 23 of CSDR allows any CSD duly authorized under the CSDR rules to provide its services in any Member State of the Union (passport rights). Article 24 of CSDR provides for various cooperation measures between home and host Member States' competent authorities where a CSD provides its services cross-border. More specifically, Article 24(4) of CSDR provides that home and host competent authorities shall establish formal cooperation arrangements for the supervision of a CSD where the activities of such CSD have become "*of substantial importance for the functioning of the securities markets and the protection of the investors"* in the host Member State.

Article 24(7) of CSDR requires the Commission to adopt delegated acts concerning measures for establishing the criteria under which the operations of a CSD in a host Member State could be considered *"of substantial importance for the functioning of the securities markets and the protection of the investors"* in the host Member State.

This mandate focuses on the technical aspects concerning the assessment of *substantial importance* within the meaning of the legislative act. In providing its advice, ESMA should build upon its own experience and from that of national authorities concerning the provision of CSD services.

1.2 Principles that ESMA should take into account

ESMA is invited to take account of the following principles:

- It should respect the requirements of the ESMA Regulation, and, to the extent that ESMA takes over the tasks of CESR in accordance with Art 8(1)(l) of the ESMA Regulation, take account of the principles set out in the Lamfalussy Report[15] and those mentioned in the Stockholm Resolution of 23 March 2001[16].

- The principle of proportionality: the technical advice should not go beyond what is necessary to achieve the objective of the delegated act set out in the legislative act.

[15] Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, chaired by M. Lamfalussy, Brussels, 15 February 2001. (http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf)

[16] Results of the Council of Economics and Finance Ministers, 22 March 2001, Stockholm Securities legislation, (http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/01/105&format=HTML&aged=0&language=EN&guiLanguage=en).

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

- In accordance with the ESMA Regulation, ESMA should not feel confined in its reflection to elements that it considers should be addressed by the delegated act but, if it finds it appropriate, it may indicate guidelines and recommendations that it believes should accompany the delegated act to better ensure its effectiveness.

- ESMA determines its own working methods depending on the content of the various aspects 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 is invited to widely consult market participants in an open and transparent manner. ESMA should provide advice which takes account of different opinions expressed by the market participants during their consultation. ESMA's technical advice should include a feedback statement on the consultation justifying its choices vis-à-vis the main arguments raised during the consultation.

- ESMA is invited to support its advice by providing a cost-benefit analysis of all the options proposed.

- The technical advice should contain sufficient and detailed explanations for the assessment done, and be presented in an easily understandable language respecting current legal terminology at European level.

- ESMA should provide comprehensive technical analysis on the subject matters described below covered by the delegated powers included in the relevant provision of the legislative act, in the corresponding recitals as well as in the relevant Commission's request included in this mandate.

- The technical advice given by ESMA to the Commission should not take the form of a legal text. However, ESMA should provide the Commission with an "articulated" text which means a clear and structured text, accompanied by sufficient and detailed explanations for the advice given, and which is presented in an easily understandable language respecting current terminology in the Union.

- ESMA should address to the Commission any question it might have concerning the clarification on the text of the legislative act, which it considers of relevance to the preparation of its technical advice.

2 Procedure

The Commission is requesting the technical advice of ESMA in view of the preparation of a delegated act to be adopted pursuant to the legislative act and in particular regarding the questions referred to in section 3 of this formal mandate.

This mandate takes into account the ESMA Regulation, the 290 Communication and the Framework Agreement.

The Commission reserves the right to revise and/or supplement this formal 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 delegated acts relating to the legislative act and will keep ESMA informed of progress made.

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

3. Scope of the technical advice

3.1 Preliminary remarks

The objective of Article 24(4) is to enhance cooperation between home and host competent authorities where the activities of a CSD in the host Member State become of *substantial importance* for a proper functioning of the financial system in that Member State.

It is the view of the Commission services that the assessment of *substantial importance* needs to focus on the core CSD services (i.e. market infrastructure services) listed in Section A of the Annex to the CSDR (initial recording of securities in a book-entry system, central maintenance and settlement services, including securities and cash settlement provided by CSDs). Therefore, the ancillary services listed in Sections B and C of that Annex that are not strictly speaking core market infrastructure services should not be considered beyond their complementary role to the core services to which they relate.

It is also the view of the Commission services that the assessment of the *substantial importance* should be done from the perspective of the host Member State and not from that of the CSD (i.e. a big CSD may have limited non-substantial activities in a small Member State from the perspective of the CSD. Nevertheless, its service may be of *substantial importance* for the host Member State). Proceeding otherwise would seriously compromise the goal of CSDR to allow a greater involvement of host Member States in the supervision of CSDs that affect substantially their markets.

3.2 Content of the technical advice

ESMA is invited to provide technical advice to assist the Commission in formulating a delegated act on the criteria to assess the *substantial importance* of the CSD's activities concerning the following three CSD core services and two related issues:

(a) Initial recording of securities in a book-entry system ('notary service');

(b) Providing and maintaining securities accounts at the top tier level ('central maintenance service');

(c) Operating a securities settlement system ('settlement service');

In addition, the three core services need to be considered in the following situations:

(a) Market consolidation affecting host Member States; and

(b) Branching into host Member States.

3.2.1 Assessment of the 'substantial importance' of notary services

ESMA is invited to examine the notary services provided by a CSD to issuers established in the host Member State. In particular, ESMA is invited to reflect on:

- Whether the assessment should:
    - cover all financial instruments issued for host Member State issuers; or
    - should be limited according to, for instance:
        - the law that governs those financial instruments (e.g. only consider financial instruments that are governed by the laws of the host Member States);
        - the type of financial instruments (e.g. for certain instruments such as shares, the involvement of host Member States is critical from the perspective of corporate or securities law).
- The appropriate methods of calculation and thresholds to capture the *substantial importance* by taking into account that such thresholds should relate to the markets of the host Member States concerned.

3.2.2 Assessment of the 'substantial importance' of central maintenance services

Central maintenance services mirror to a large extent the issuance services (i.e. a CSD responsible for the issuance of a given security is also normally responsible for the maintenance of the relevant securities accounts at the top tier level). Therefore, the technical advice is expected to cover *mutatis mutandi* the issues referred to in the previous subsection, even though in certain cases the CSDs may not provide the notary service themselves.

3.2.3 Assessment of the 'substantial importance' of settlement services

ESMA is invited to reflect on whether:

- The settlement services need to be assessed:
    - only from the perspective of the issuers (i.e. the *substantial importance* test takes into account only settlement services related to the financial instruments issued and/or centrally maintained by a CSD on behalf of the issuers established in a host Member State); or
- should also be assessed from the perspective of the participants to a securities settlement system operated by a CSD and/or of the participants to trading venues in a host Member State (i.e. the 'substantial importance' test takes also into account the settlement services provided to financial institutions from the host Member State).
- For the first aspect of the point above, the technical advice should cover *mutatis mutandi* the issues referred to in subsection 3.2.1.

- For the second aspect of the point above, ESMA is invited to reflect on the principles (i.e. methods of calculation and thresholds) for assessing the *substantial importance* of a CSD for a host Member State from the perspective of the participants from that host Member State to a securities settlement system from a different Member State, and/or of the participants to trading venues in the host Member State for which the CSD in a different Member State provides settlement services either directly or indirectly.

3.2.4 Market consolidation affecting host Member States

Currently, there is at least one CSD in each Member State. In the medium/long term, the CSD market may consolidate as a result of increased competition, mergers, takeover, or any other form of business transfer. ESMA is invited to reflect on how to apply/adapt the criteria developed for assessing the *substantial importance* where a host Member State has no longer a 'local' CSD (in particular if the activity of a CSD in a host Member State is taken over by more than one CSD where neither of them individually meet the criteria for *substantial importance*).

3.2.5 Branching into host Member States

The physical presence through a branch is a strong indication of the importance for the host Member State of the activities of a CSD in that Member State. ESMA is invited to reflect on how to apply/adapt the criteria developed for assessing the *substantial importance* in the context of branching.

4. 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 delegated acts according to Article 290 of the TFEU. The powers of the Commission to adopt delegated acts are subject to Article 68 of the legislative act which allows the European Parliament and the Council to object to a delegated act within a period of 3 months, extendible by 3 further months. The delegated act will only enter into force if neither European Parliament nor the Council has objected on expiry of that period or if both institutions have informed the Commission of their intention not to raise objections.

The deadline set to ESMA to deliver the technical advice is nine months after the entry into force of CSDR.

Annex III – IMPACT ASSESSMENT

Introduction

This Impact Assessment is being published to provide the European Commission with an analysis of the costs and benefits attached to the Technical Advice provided by ESMA on the level of penalties for settlement fails and on the substantial importance of a CSD. It should be noted that ESMA had limited data available, in part due to the absence of data provided by stakeholders during the two public consultations ran by ESMA.

1. PENALTIES FOR SETTLEMENT FAILS

This Section provides an assessment of the costs and benefits of different options analysed to develop the Technical Advice on assessing the parameters and circumstances to be considered in order to determine the amount of cash penalties in case of settlement fails.

1.1 Parameters for calculating the basic cash penalty

In this part of the impact assessment we analyse the elements that should be taken into account for such calculations.

In the mandate to ESMA, the Commission shared its view that the penalty should take into account the value of the transaction in order to be deterrent and proportionate. The Commission stressed that the parameters should be sufficiently simple to be applied via an automated system. With this in mind, an ad-valorem penalty rate is most appropriate, as it would fully consider the value of the settlement fail. Therefore it is necessary to determine a consistent indicator for calculating the value of the cash/instruments that have failed to settle.

The calculation of a cash penalty amount should be based on: (1) the basis on which the cash penalty should be calculated and (2) the rate that should be applied on that basis. The following questions are considered below:

1) what price should be used as a basis for the calculation of the cash penalty for each transaction that fails to settle,
2) what source should be used for the provision of such price to CSDs,
3) what price should be used when a transaction fails to settle for more than one day,
4) whether securities or cash standing on the account of the failing party should be taken into account for the calculation of the penalty when partial delivery is refused, and
5) what asset types should be considered and what rate should be applied to each asset type?

1.1.1 The basis for the cash penalty calculation (Reference price)

Specific Objective	**To determine the value of the transaction that fails to settle**
Option 1	Using the price of the specific transaction that fails to settle (i.e. the price indicated in the failing settlement instruction)
Option 2	Using a reference price for the underlying financial instrument, referring to: (1) closing price of the most relevant market; or if not available, (2) price of the most liquid trading venue for the relevant financial instrument; or if not available, (3) pre-determined methodology (using criteria relating to market data such as market prices available across trading venues or brokers).
Preferred Option	**Option 2** – this approach ensures that there is a consistent framework in place across CSDs to determine the basis for calculating the penalty in case of settlement fails.

Impacts of the proposed policies

Option 1	Using the price of the **specific transaction** that has failed to settle as indicated in the settlement instruction.
Benefits	The price is readily available in the settlement instruction
Costs to regulator: - *One-off* - *On-going*	Cost of checking the prices of each transaction that fails to settle. This will be a greater cost than that associated with option 2 as there will be different prices for transactions on the same financial instrument.
Compliance costs: - *One-off* - *On-going*	Limited. The IT system required to identify the price of the specific transaction should not be complex.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	No difference between the two options.

Option 2	Using a **reference price** for the underlying financial instrument, referring to: (1) closing price of the most relevant market; or if not available, (2) the price of the most liquid trading venue for the relevant financial instrument; or if not available, (3) pre-determined methodology (using criteria relating to market data such as market prices available across trading venue or brokers)
Benefits	- Allows using a common price and approach for similar financial instruments in CSDs.

	- Protection of the mitigation effect of the collection and redistribution mechanism of the penalty in case of chain of fails. - Respects the proportionality principle and effectiveness of the penalty. - Addresses the issue of free of payment (FOP) settlement instructions and non-market considerations, or settlement instructions that do not individually present an economic rationale. - Can be applied via an automated system.
Costs to regulator: - *One-off* - *On-going*	As only one price applies for similar financial instrument across different transactions, the costs to regulators will be more limited than in option 1.
Compliance costs: - *One-off* - *On-going*	Cost to identify the reference price. Given that this price is widely available and when it is not a pre-determined methodology can be used, this cost should be pretty limited.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	No difference between the two options.

Option 2 was considered the most appropriate way to determine the price to use for the securities that had failed to settle. To devise the advice, ESMA reviewed existing arrangements at a number of CSDR and non-CSDR CSDs and ICSDs to understand how existing procedures functioned.

Based on this analysis it is apparent that there are a number of approaches taken in the market. One CSD applies a daily ad valorem rate to failed net settlements using the 'current national currency value'. Another CSD refers to the cash value of the fail to be the relevant price for the calculation. Another CSD refers to the MTM balances of the fails, the market price on the preceding day.

The proposed approach (option 2) ensures a clear, efficient and harmonised way of determining prices to use for calculating the penalty. This will ensure that all fails on the same instruments occurring on a particular date are treated equally, irrespectively of the trading venue or CSD used. This avoids potential regulatory arbitrage and provides for a clear methodology for determining the reference price with limited possibilities for conflicting interpretations of the relevant price to use in these situations.

1.1.2 Sources for the provision of the reference price

In order to determine the best approach for the provision of the reference price, ESMA has analysed several alternatives.

Specific Objective	**To determine who should provide the reference price to be used for the calculation of the penalty**

Option 1	Single source: ESMA as central point.
Option 2	CSDs to determine the information provider – EU CSD should identify and use a similar source in order to get the reference price.
Preferred Option	Options 2 – It allows the CSDs to determine the best service provider and preserves harmonisation of the rules set to determine the reference price.

Impacts of the proposed policies

Option 1	Single source: **ESMA** as central point
Benefits	Single central source of information.
Costs to regulator: - *One-off* - *On-going*	ESMA would be required to pay an on-going fee to a provider to receive this information. ESMA would need to set up an IT infrastructure for doing this, for which it has not received a specific mandate. ESMA will not be able to recover this cost, thus this cost would impact taxpayers, rather than the users of this service.
Compliance costs: - *One-off* - *On-going*	Costs for the relevant communication arrangements and services between CSDs and ESMA.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	Allow each CSDs to determine the information **provider**
Benefits	- Allows identification of the best service provider among a number of possibilities - Allows harmonisation given the rules on reference prices
Costs to regulator: - *One-off* - *On-going*	None
Compliance costs: - *One-off* - *On-going*	The cost will be sustained by the CSD to pay the service provider. The CSD will recover this cost as part of its services to its users.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

1.1.3 Reference Price to be used when a transaction fails to settle for several days

When settlement fails last for several days, should the reference price remain the same for each day when the transaction fails or should it be updated on a daily basis? ESMA has analysed the different alternatives.

Specific Objective	**To determine the reference price to be used for penalty calculations when settlement failures occur for several days**
Option 1	Intended settlement date (ISD) reference price to be kept for all days when the transactions keeps on failing (e.g. Day 1 reference price of day 1 – Day 2 reference price of day 1 – Day 3, reference price of day 1)
Option 2	Daily reference price (use the reference price set each day e.g. Day 1 reference price of day 1 – Day 2 reference price of day 2 – Day 3, reference price of day 3)
Preferred Option	**Option 2** - this option ensures that prices used to calculate penalty amounts reflect the current market conditions and a more proportionate application of the fines.

Impacts of the proposed policies

Option 1	**ISD reference price** should be used on each day when the fail continues. If the settlement of transactions on similar instruments fails on different ISDs, on each day when the fail continues there may be different prices for the same financial instrument depending on the respective ISD of each transaction.
Benefits	Simple approach for participants with low levels of activity, e.g. one transaction per month.
Costs to regulator: - *One-off* - *On-going*	None
Compliance costs: - *One-off* - *On-going*	This will be more costly than option 2, in particular for more active market participants. For a same day, the entity required to calculate the penalty will need to cater for multiple prices for one single instrument. This complexity will come at an increased cost to CSDs and other market participants.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	Does not ensure respect of immunization principle in case of chain of fails nor protect the mitigation effect of the collection and redistribution mechanism. In particular, in case of a buyer and seller of the same instrument at different dates (which both fails), it would continue to pay different level of penalties for all the days for which the instructions fails, even if it has a net position.

Option 2	**Daily reference price**: the price of each day where the instruction fails to settle should be used as the reference.
Benefits	- Ensures that in case of chain of fails in different days, no discrepancy is possible i.e. the immunization principle is ensured. - Protects the mitigation effect of the collection and redistribution mechanism of the penalty in case of a chain of fails. - Less costly system implementation costs because there will only be one price per instrument per day.
Costs to regulator: - *One-off* - *On-going*	None.
Compliance costs: - *One-off* - *On-going*	The IT system would be less complex than in option 1
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None.

1.1.4 Available securities and cash in the absence of partial delivery

When partial delivery is refused and before the application of mandatory partials, there will be failing participants that have part of the securities or cash standing on their accounts. ESMA analysed whether it would be appropriate to take into account, for the calculation of the penalty, the part of the cash or of the securities available to the failing participant.

Specific Objective	**To determine whether the cash penalty should be calculated on the full amount of the transaction that fails to settle or whether the cash or securities standing on the account of the failing participant should be taken into account.**
Option 1	Apply the cash penalty to the full amount of the transaction that fails to settle
Option 2	Apply the cash penalty to the missing part of the cash or securities in view of the available cash or securities standing on the account of the participant
Preferred Option	**Option 1**

Impacts of the proposed policies

Option 1	Apply the cash penalty to the **full amount** of the transaction that fails to settle

Benefits	More simple to develop an automated IT system to determine the value of the penalty.
Costs to regulator: - *One-off* - *On-going*	Easier to monitor, therefore the cost for regulators would be smaller than option 2.
Compliance costs: - *One-off* - *On-going*	Cheaper than option 2 for CSDs because less complex IT systems will be required to calculate penalty values.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	Apply the cash penalty to the **missing part** of the cash or securities in view of the available cash or securities standing on the account of the participant
Benefits	This approach may be deemed more proportionate as it takes into account the fact that some securities/cash are available on the account of the failing participant but cannot be delivered.
Costs to regulator: - *One-off* - *On-going*	More complex for the regulator to monitor than option 1 due to the less straightforward calculations that would need to be carried out to determine the part of securities or cash on which to apply the cash penalty.
Compliance costs: - *One-off* - *On-going*	The option will require a more complex IT system than in option 1, to ensure that the correct penalty applies.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

1.1.5 Penalty Rates

The following questions are considered below, taking into account the type of transactions concerned, the different asset types and respective degrees of liquidity: (1) what rate should be applied and (2) what categories should be considered.

Rates

Specific Objective	**To determine the appropriate levels of penalty rates**
Option 1	Look at the liquidity of the financial instruments and use as the basis for the calculation the actual borrowing rate per type of financial instruments, plus a mark-up.
Option 2	Look at the liquidity of the financial instruments and use as the basis for the calculation an average borrowing rate per type of financial instruments, plus a mark-up.
Option 3	Look at the characteristics of the financial instruments and impact on their liquidity that the level of cash penalty might have.
Preferred Option	**Option 3**

Impacts of the proposed policies

Option 1	Look at the liquidity of the financial instruments and use as the basis for the calculation the **actual borrowing rate** per type of financial instruments**,** plus a mark-up.
Benefits	- Objective measurement. - Dissuasive effect on less liquid instruments will be more in line with relevant markets conditions.
Costs to regulator: - *One-off* - *On-going*	None.
Compliance costs: - *One-off* - *On-going*	Same for all options
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	Less liquid instruments might be disproportionately penalised, thus further limiting the trades on these instruments and therefore negatively impacting on their liquidity. This would have a negative effect on the economy, penalise small and medium entities and disincentivise market financing, which is contrary to the objective of the Capital Markets Union (CMU).

Option 2	Look only at the liquidity of the financial instruments and use as the basis for the calculation an **average borrowing rate** per type of financial instruments, plus a mark-up.
Benefits	- Objective measurement. - It will allow correctly applying a higher penalty to more liquid (therefore easier to find) instruments.
Costs to regulator: - *One-off* - *On-going*	None.
Compliance costs: - *One-off* - *On-going*	Same for all options
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	An average borrowing cost might be disproportionate for highly liquid instruments and not dissuasive (cost of failing lower than the borrowing cost) for less liquid ones.

Option 3	Look at the **characteristics** of the financial instruments and **impact on their liquidity** that penalty rates might have.
Benefits	- Allows for more proportionate results - Incentivises SMEs - Contributes to the CMU
Costs to regulator: - *One-off* - *On-going*	None.
Compliance costs: - *One-off* - *On-going*	Same for all options
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	The introduction of a discretionary system not based on market measures (borrowing costs), but more based on current practices adapted to the characteristics of the different products might have distortive effects. Unfortunately certain markets and products (e.g. SME bonds) are not well developed and too illiquid to rely on any appropriate market measurement. In many cases no measurement exists. Therefore, this approach will certainly have lower impacts on the overall economy than a system based on borrowing costs. It would probably not provide deterrent effects for certain instruments, but if the deterrent effect turns into a deterrent to trade such instruments, the objective of limiting fails would be fulfilled at the damage of the whole economy, which was certainly not the intention of the legislators.

To determine the rates which are proposed in the technical advice, information gathered from existing CSDs and ICSDs operating in Europe, both inside and outside the jurisdiction of CSDR was used.

Where existing arrangements used ad-valorem penalty rates for settlement rates, the different scenarios used different types of assets as categories for different penalty rates for settlement fails.

These categories were wide-ranging and ESMA considered this when drafting the technical advice. An appropriate set of categories was decided upon, taking into account different assets and also the varying liquidity of the assets.

Research conducted showed that penalty rates in European CSDs were reasonably spread out. Based on the date collected, penalty rates ranged from 0.5% of market value per day, to 0.1% of cash values for securities on each day the securities are not delivered, to 0.02% of market price on the preceding day (for all securities).

For fixed income, there are not as many examples of ad-valorem rates being applied to calculate penalties for settlement fails. Based on the evidence collected it appears that CSDs in Europe tend to use fixed penalties for settlement fails. One CSD that does currently make use of an ad-valorem penalty rate for fixed income charges 0.001% of the preceding day's market price for all bonds.

Based on these figures, ESMA has considered the feedback from the market supporting penalties based on asset type and liquidity, and accordingly suggested multiple ad-valorem penalty rates.

The levels of the rates within the categories were decided by considering the existing information and the feedback from the consultation. As this was in favour of addressing the matter by including multiple categories, with an emphasis on the different liquidities of different instruments, the proposed approach was drafted as such.

It also follows a more granular approach, setting up differentiated treatment for each category of assets considered, and even within a category, according to the characteristics of the instruments or the markets considered:

- distinction between liquid and illiquid shares given the different characteristics of the two and the different impact on their liquidity of the same penalty rate;

- the rate for bonds has been set lower than for shares, considering the big size of related transactions;

- the rate applicable to transactions on corporate bonds should be higher than the one applicable to government bonds as the transaction size in corporate bonds are generally

lower than in government bonds;

- although there is no relevant data on SME Growth Markets to estimate the appropriate level of penalties, considering the level 1 requirement to treat them specifically to support their development due to the specificities of the SME growth markets, the applicable rate for SME Growth Market shares is lower than for other illiquid shares, and in the same manner the rate for the SME growth markets bonds are lower than for other corporate bonds.

In case a failure is due to a lack of cash, the rate should be the cost for borrowing that cash, which can be found in the official discount rate for the relevant currency – with a floor to zero in order to maintain the deterrent effect of the penalty even in case of negative interest rates.

Revision on an ad hoc basis

As indicated in the above table it is intended that there should be regular calibration to adapt to changing market conditions and to monitor the overall efficiency of the measures. ESMA believes there would be value in a regular review of the different penalty rates proposed in the advice.

Asset types

Specific Objective	**To determine the appropriate categories considering the asset type and liquidity**
Option 1	**4 asset types**: - equities and others - government bonds - corporate bonds - cash
Option 2	**7 asset types**: - liquid shares (MIFID definition) - illiquid shares and others financial instruments - SME Growth Market shares and other financial instruments - corporate bonds - SME Growth Market bonds - Government and municipal bonds - cash
Preferred Option	**Option 2**

Impacts of the proposed policies

Option 1	**4 asset types**: - equities and others - government bonds - corporate bonds - cash.
Benefits	- well known broad categories, sufficiently simple to develop an automated system - simpler IT systems - limited granularity makes it less expensive
Costs to regulator: - *One-off* - *On-going*	Less expensive for regulators as decreased granularity.
Compliance costs: - *One-off* - *On-going*	Less expensive as decreased granularity in comparison to option 2
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	Substantial, as the lack of granularity would penalise in a disproportionate manner instruments showing specific characteristics (as describe in the section above).

Option 2	**7 asset types**: - liquid shares - illiquid shares and others financial instruments - SME Growth Market shares and other financial instruments - corporate bonds - SME Growth Market bonds - government and municipal bonds - cash.
Benefits	- allows a better granularity and consideration of the liquidity and particular characteristics of the types of instruments; - additional categories for SME Growth Market shares and bonds, which specificities are such that they require specific treatment under the CSDR
Costs to regulator: - *One-off* - *On-going*	Higher, given the need to monitor different categories of instruments and verify that all relevant market participants and CSDs have properly classified the different instruments.
Compliance costs: - *One-off* - *On-going*	The one-off cost will certainly be higher than option 1. However, this cost derives from the wording of the level one text and the particular treatment requested in the CSDR for SME Growth Markets instruments. Therefore the cost and benefit for introducing such a special treatment were already assessed at the time of the adoption of the CSDR.

	Once the system is in place, the compliance costs for a more granular system should be limited.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	Much lower than in option 1, for the reasons detailed in the previous section on the rates. Indeed having a more detailed classification is for the purpose of applying different rates to the different categories.

1.2 Increase or reduction of the basic amount of the cash penalty

Specific Objective	**To determine whether level of penalty should vary depending on the circumstances**
Option 1	Increase for entities that systematically fails, decrease for entities with limited fails. Increase or decrease should be calculated as a percentage of the transaction value rather than in absolute terms.
Option 2	Increase only, but no decrease.
Option 3	No increase or decrease
Preferred Option	**Option 3**

Impacts of the proposed policies

Option 1	**Increase for entities that systematically fails, decrease for entities with limited fails**. Increase or decrease should be calculated as a percentage of the transaction value rather than in absolute terms.
Benefits	In case of entities that systematically fails, this option would give an additional deterrent effect to the penalty and further improve settlement efficiency. For the same reasons decreasing the penalty rates for entities that perform better would also incentivise better behaviours in terms of settlement efficiency.
Costs to regulator: - *One-off* - *On-going*	More complex monitoring.
Compliance costs: - *One-off* - *On-going*	Highest cost of the three options. The system would be complex to implement and to apply. Such costs would be aligned to the type of fails that occur. The settlement fail penalty module required by a CSD will need to include complex IT systems that can calculate penalties according to the systematic or sporadic nature of a fail.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.

Indirect costs	CSDs might not classify all participants equally, so the participants using multiple CSDs to settle would face different rates for the same instruments, which would be contrary to the immunisation principle. In addition, there would be no ability to pass-on an equivalent penalty in a chain of interdependent transactions.

Option 2	**Increase only, but no decrease**.
Benefits	Less complex to implement than option 1 and similar benefits as option 1 in terms of incentives.
Costs to regulator: - *One-off* - *On-going*	Similar to option 1, complex monitoring of the different rates applied and the reasons for it.
Compliance costs: - *One-off* - *On-going*	Compliance costs lower than in option 1, because of the reduced complexity, but still substantial because the major complexities will remain.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	Similar to option 1

Option 3	**No increase nor decrease**
Benefits	- Ensures that the penalties applied to buyers are always the same as the one applied to sellers, guaranteeing the immunisation principle. - Simple to implement
Costs to regulator: - *One-off* - *On-going*	No additional cost of monitoring as this option does not add complexity to the penalty regime.
Compliance costs: - *One-off* - *On-going*	No additional cost to the general implementation cost of the penalty regime.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	Lower incentives to settlement efficiency.

In the answers to the discussion paper some stakeholders raised the issue of financial instruments that cannot be settled for reasons independent from the participants or CSDs. ESMA has considered this and agreed that it is appropriate to allow for a mitigant to these potentially unfair circumstances by removing the penalty (reducing it to zero) in exceptional cases such as:

- suspension of the instrument from trading and settlement due to reconciliation issues,
- specific corporate actions implying the instrument no longer exists, or

- technical impossibilities at the CSD level.

1.3 Calculations in the context of chains of interdependent transactions

Specific Objective	**To determine whether the parameters for calculating/allocating the payment of basic amount of cash penalties should be adapted in the context of chain transactions**
Option 1	Modification of the calculation of penalties, e.g. a calculation method that considers the transactions which suffer a detrimental impact in the event of an original transaction failing in order to avoid penalising entities within a chain that cause a fail only because of a fail in the chain.
Option 2	No modification of the calculation of penalties.
Preferred Option	**Option 2**

Impacts of the proposed policies

Option 1	**Modification** of the calculation of penalties
Benefits	Reinforce the accountability of the original failing party.
Costs to regulator: - *One-off* - *On-going*	More complex as the chain needs to be identified and there may be participants from several jurisdictions involved.
Compliance costs: - *One-off* - *On-going*	More complex and costly than option 2, chains will need to be identified and the parameters of the CSD IT systems will need to be adapted.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	Not sufficiently simple to be applied via an automated system Costs of developing complex communication networks between IT systems

Option 2	**No modification** of the calculation of penalties
Benefits	The redistribution of penalties for an amount equal to that collected would allow mitigating the impact of the fail for those in the middle of the chain. Given the difficulty to identify the failing participant who originally failed in a chain of interdependent transactions, this mechanism protects participants that are being failed from being penalised. This approach ensures that counterparties that are acting as intermediaries in a chain remain effectively "flat" in terms of exposure.
Costs to regulator: - *One-off* - *On-going*	This is a more simple approach which would be less costly for regulators, for example with regard to the complexity of required IT systems.
Compliance costs: - *One-off* - *On-going*	Compliance costs for CSDs will be limited as there is no requirement for the identification of the failed transaction in a chain of interdependent transactions
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	n/a

2. CRITERIA TO ASSESS THE SUBSTANTIAL IMPORTANCE OF A CSD

Section two of this Annex provides an assessment of the costs and benefits of different options considered to develop the Technical Advice on assessing the substantial importance of a CSD. A number of questions are included below which refer to the options considered and reasons justifying the proposal included in the final Technical Advice submitted to the EC.

2.1 The level of the thresholds used to determine a CSD's substantial importance

What is the most appropriate level for the thresholds which deem a CSD in a host Member State to be of substantial importance?

Specific Objective	**Propose a threshold that will ensure the substantial CSDs acting in a host Member State are caught by the threshold.**
Option 1	Propose a threshold of 15% for each of the core CSD services which will be assessed to determine substantial importance.
Option 2	Propose a threshold of 25% for each of the core CSD services which will be assessed to determine substantial importance.
Preferred Option	**Option 1** - Use a 15% threshold.

Impacts of the proposed policies

Option 1	*Propose a threshold of **15%** for each of the core CSD services*
Benefits	- Greater involvement of authorities, which is the objective of the specific provision of the CDSR. Given the results of the simulation exercise run by ESMA, as well as the CP input, this threshold will ensure that it will capture CSDs of substantial importance for the host Member States. According to the results of the simulation exercise run by ESMA, in the case of the notary and/or central maintenance services from the issuers' perspective, a 15% threshold would capture 5 more host Member States than a 25% threshold. - Increased harmonisation and consistent application of the CSDR.
Costs to regulator: - *One-off* - *On-going*	The cost to the regulator of a 15% threshold will be higher overall than in option 2 because more CSDs will be caught and classified as substantially important in host Member States. The home authority will sustain more costs in view of the requirement to cooperate with host authorities and host authorities will sustain more costs as they will need to be involved in the supervision of the relevant CSD.
Compliance costs: - *One-off* - *On-going*	- The overall compliance costs of this option will be higher than option 2. More CSDs will be caught and therefore the overall impact will be greater. - CSDs will be subject to a greater scrutiny, so their compliance costs will increase.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	*Propose a threshold of **25%** for each of the core CSD services*
Benefits	Captures less CSDs of substantial importance for host Member States, reducing the number of authorities that would need to establish cooperative arrangements under Article 24 of CSDR. According to the results of the simulation exercise run by ESMA, in the case of the notary and/or central maintenance services from the issuers' perspective, a 25% threshold would capture 5 less host Member States than a 15% threshold.
Costs to regulator: - *One-off* - *On-going*	This option will capture fewer substantially important CSDs and therefore the costs for regulators will be less because there will be fewer cooperation arrangements required between regulators.
Compliance costs: - *One-off*	Compliance costs for CSDs will be smaller than for option one because there will be fewer CSDs that are substantially important in multiple host

- *On-going*	Member States.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

The consultation feedback on technical advice indicated that the majority of respondents were content with the 15% threshold regarding the activity of a CSD in a host Member State, as an indicator of substantial importance. Some respondents indicated that they felt a higher threshold would be more appropriate.

Some respondents signalled that the 15% threshold would lead to the creation of 'colleges' of NCAs (national competent authorities) with substantial interests in host Member State CSDs. With regard to this, it is important to realise that the CSDR does not refer to a requirement to have formalised colleges created in the way indicated by other European regulatory texts. The intention of this proposal and a 15% threshold is to ensure that all of the appropriate NCAs are involved in the supervision of substantially important CSDs to protect the interests of investors. The NCAs are likely to already have in place cooperation arrangements; this will ensure an efficient supervision operation is possible for substantially important CSDs without significantly increasing the associated costs for regulators and CSDs.

ESMA's proposal to undertake a simulation exercise before the draft technical advice was finalised was welcomed by several respondents to the consultation. The purpose of the simulation was to identify which would be the authorities that would need to enter into cooperation arrangements in the case of each CSD under Article 24 of CSDR.

The exercise involved reaching out to the markets and requesting data covering the year 2014 in respect of the proposed indicators. Even though the figures provided by the CSDs only covered the notary and/or central maintenance indicator from issuers' perspective, they supported the relevance of the 15% in this case, capturing predominantly the two ICSDs.

Substantially important CSDs	Host Member States for which CSDs are substantially important depending on each threshold in the case of the notary and/or central maintenance service from the issuers' perspective	
CSD	25%	15%
A	1	1
B	5	8
C	2	2
D	5	7

2.2 Frequency of assessments of substantial importance

How frequently should a CSD be assessed to ensure CSDs of substantial importance are subject to the appropriate supervision?

Specific Objective	**Assess the substantial importance of a CSD in a host Member State on a timely basis**
Option 1	Assess substantial importance every year.
Option 2	Assess substantial importance less frequently than every year.
Option 3	Assess substantial importance more frequently than every year.
Preferred Option	**Option 1** – assess the substantial importance of a CSD in a host Member State on an annual basis.

Impacts of the proposed policies

Option 1	*Assess the substantial importance of a CSD in a host Member State on an **annual basis***
Benefits	Ensures a regular assessment of data in order to reflect the changes in the services provided by a CSD in a timely manner, ensuring the adequate involvement of the authorities in the relevant Member States in the supervision of a CSD.
Costs to regulator: - *One-off* - *On-going*	The cost of this option will be greater than option 2 and lower than option 3, given the need to centralise and assess the data, as well as the need to potentially update the cooperative arrangements based on the new assessments.
Compliance costs: - *One-off* - *On-going*	The compliance costs of this option will be greater than for option 2 and lower than for option 3, given the need for the CSDs to collect the data and submit it to the regulators.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	*Assess substantial importance **less frequently** than every year.*
Benefits	Ensures a reasonably regular assessment of relevant data to ensure the correct supervision is applied to CSDs operating in different jurisdictions within the EU. However, there may be occasions where substantially important CSDs are not properly captured by the indicators because of the less frequent cycle of assessments.
Costs to regulator: - *One-off* - *On-going*	The cost of this option will be less than for options 1 and 2.

Compliance costs: - *One-off* - *On-going*	The compliance costs of this option will be less than for options 1 and 2.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 3	*Assess substantial importance **more frequently** than every year.*
Benefits	The benefits of this option relate to the increased scrutiny afforded in assessing the substantial importance of a CSD in a host Member State. More regular assessments will deliver up to date indications of substantial importance.
Costs to regulator: - *One-off* - *On-going*	The costs for regulators will be higher than for options 1 and 2.
Compliance costs: - *One-off* - *On-going*	Compliance costs are likely to be increased for this option, compared to options 1 and 2.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Assessment on an annual basis is proposed by ESMA for practical reasons, given that the data required for the calculation of the indicators is quite extensive and involves aggregation at EU level. Requesting the data to be submitted on an annual basis is a proportionate approach. It will ensure CSDs are assessed for substantial importance on a regular basis and also take into account the most appropriate associated compliance costs of carrying out such an assessment for CSDs themselves. In addition, the CSDs' activity relevant for the calculation of the threshold is not expected to fluctuate significantly during a year to require a more frequent assessment. Finally, a yearly assessment is consistent with the CCP college composition, which is also re-assessed on an annual basis.

2.3 Combining the proposed indicators as part of the assessment

Should each indicator be looked at separately, or should assessments of substantial importance be done by focusing on a CSD's performance across the spectrum of the proposed indicators?

Specific Objective	**Ensure that the CSDs that are of substantial importance to a host Member State are caught by the indicators and thresholds**

Option 1	Consider indicators individually, if a threshold is reached for one indicator then define the CSD as significant accordingly.
Option 2	Require at least two of the indicator thresholds to be reached by an individual CSD to consider the CSD of substantial importance.
Preferred Option	**Option 1** – consider each indicator on an individual basis when determining the substantial importance of a CSD in a host Member State.

Impacts of the proposed policies

Option 1	*Consider indicators individually, if a threshold is reached for one indicator then define the CSD as significant accordingly*
Benefits	This option will ensure that even if a CSD provides just one core service in a host Member State, but that core service is substantially important, then it would be captured.
Costs to regulator: - *One-off* - *On-going*	There may be additional costs to the regulator, as it is possible that more CSDs will be captured as substantially important than under option 2. Therefore there may be increased costs for regulators linked to a need for increased cooperation arrangements.
Compliance costs: - *One-off* - *On-going*	It is likely that more CSDs will be caught and classified as substantially important if this option is adopted. Therefore the overall compliance cost for CSDs in general is likely to be higher.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	*Require at least two of the indicator thresholds to be reached by an individual CSD to consider the CSD of substantial importance*
Benefits	This approach will ensure that those CSDs captured as substantially important are substantially important in terms of the services they provide in more than one way.
Costs to regulator: - *One-off* - *On-going*	It is likely that less CSDs will be caught and classified as substantially important if this option is adopted. Therefore the overall compliance cost for CSDs in general are likely to be less than for option 1.
Compliance costs: - *One-off* - *On-going*	The overall compliance cost is likely to be less because there will be a smaller number of CSDs classed as substantially important, and thus a smaller number will need to conform to two or more national authorities.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

2.4 Assessment of the 'substantial importance' of notary services and/or central maintenance services: issuers' perspective

Which financial instruments should the assessment of the notary services and/or central maintenance services consider?

Specific Objective	**Cover all relevant financial instruments for making an assessment of a CSD's substantial importance in a host Member State with regard to the notary services and/or central maintenance services from the issuers' perspective.**
Option 1	Capture the law that governs a financial instrument when considering the appropriate financial instruments to include in the assessment.
Option 2	Consider financial instruments according to the jurisdiction of their issuer, referring to the home jurisdiction of the issuer which has issued the securities initially recorded and/or centrally maintained by the CSD.
Preferred Option	**Option 2** – use an indicator based on the issuers' perspective based on the jurisdiction where issuers are incorporated.

Impacts of the proposed policies

Option 1	*Capture the **law that governs a financial instrument** when considering the appropriate financial instruments to include in the assessment.*
Benefits	Since issuers may opt to issue in a particular jurisdiction depending on their targeted investors, this may represent a link to the substantial importance of the CSD for the investors in that jurisdiction.
Costs to regulator: - *One-off* - *On-going*	No obvious differences between the two options in terms of the costs to the regulators.
Compliance costs: - *One-off* - *On-going*	No obvious differences between the two options in terms of the compliance costs.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	*Consider financial instruments according to the **jurisdiction of their issuer**, referring to the **home jurisdiction of the issuer** which has issued the securities initially recorded and/or centrally maintained by the CSD.*
Benefits	This option will ensure a broader approach to capturing the notary and/or central maintenance services by a CSD in a host Member State, based on the issuers' perspective, irrespective of their choice of law for

	issuing specific securities. Given that issuers might have different reasons for issuing in another country and the CSDR opens for this opportunity, looking at the law of the instruments would not allow considering that a CSD is providing services to issuers in another country and therefore might be of substantial importance for that country.
Costs to regulator: - *One-off* - *On-going*	No obvious differences between the two options in terms of the costs to the regulators.
Compliance costs: - *One-off* - *On-going*	No obvious differences between the two options in terms of the costs to the regulators.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

In response to the CP on the Technical Advice, stakeholders considered the notary service indicator to be appropriate. As confirmed above, Option 2 was selected to be included in the Technical Advice. Issuers may opt to issue in a particular jurisdiction depending on their targeted investors or type of instruments or for other reasons (tax, CSD services, etc.). It does not seem appropriate to focus on instruments that are governed by a certain law, as this may not capture the full extent of the notary and/or central maintenance services by a CSD in a host Member State.

2.5 Assessment of the 'substantial importance' of central maintenance services: participants' perspective

Should central maintenance services be considered from the participants' angle as a criterion for substantial importance?

Specific Objective	**Ensure all relevant services are considered when making assessments on a CSD's substantial importance in a host Member State from the most appropriate perspective**
Option 1	Consider the central maintenance service from the participants' angle based on their country of incorporation.
Option 2	Consider the central maintenance service based on the investors' nationality/country of incorporation.
Preferred Option	**Option 1** – consider the central maintenance service from the participants' angle.

Impacts of the proposed policies

Option 1	*Consider the central maintenance service from the **participants' angle***

	***based on their country of incorporation**.*
Benefits	To the extent that a CSD does not have the necessary information on the end investors and that it would be problematic to compute such a calculation, participants of the host Member State would be a proxy for investors and should help ensure there is consideration of the protection of investors in the host Member State.
Costs to regulator: - *One-off* - *On-going*	A possible cost of this option for the regulator would relate to the cost of assimilating the data required to calculate the 'denominator' in the calculation referenced in the technical advice. This applies to both option 1 and option 2, and will be lower for option 1, given the data is less complex to collect and monitor. In order to ensure consistency and comparability of the data, the data could potentially be collected and aggregated by ESMA.
Compliance costs: - *One-off* - *On-going*	The compliance costs for CSDs for this option will be significantly lower than those associated to option 2, given the data necessary for the calculation of the indicator is less complex to collect.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	*Consider the central maintenance service based on the **investors' nationality/country of incorporation**.*
Benefits	Using the nationality/ country of incorporation of the original investors to determine a CSD's substantial importance in a host Member State will provide the most accurate indication of the need for a CSD to be considered substantially important as the overall aim of the concept of substantial importance includes investor protection.
Costs to regulator: - *One-off* - *On-going*	A possible cost of this option for the regulator would relate to the cost of assimilating the data required to calculate the 'denominator' in the calculation referenced in the technical advice. This applies to both option 1 and option 2, and will be higher for option 2, given the data is more complex to collect and monitor. In order to ensure consistency and comparability of the data, the data could potentially be collected and aggregated by ESMA.
Compliance costs: - *One-off* - *On-going*	The compliance costs of this option would be much greater than option 1. It would be very difficult for CSDs to determine the nationality/ country of incorporation of all the investors that have invested in financial instruments which are centrally maintained in the CSD.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.

Indirect costs	None

ESMA proposes that the central maintenance service is assessed using data from the participants' angle. ESMA notes that the reference to the home jurisdiction of the participant which holds the security at top tier level will not achieve a fully accurate representation of the investor side.

Nevertheless, to the extent that a CSD does not have the necessary information on the end investors, and that it would be extremely costly and problematic for CSDs to compute such a calculation, participants of the host Member State would be a proxy for investors and should help ensure there is consideration of the protection of investors in the host Member State.

2.6 Assessment of the 'substantial importance' of settlement services

From which perspective should the 'substantial importance' of settlement services be considered?

Specific Objective	**To ensure the substantial importance of a CSD is accurately captured taking into account all relevant perspectives and all relevant indicators.**
Option 1	Consider the substantial importance of a CSD by analysing settlement services only from the perspective of the issuers.
Option 2	Consider settlement services only from the perspective of participants in a securities settlement system operated by a CSD.
Option 3	Consider the substantial importance of settlement services from the perspective of the issuers and also separately from the perspective of the participants.
Preferred Option	**Options 3**– consider the substantial importance of a CSD by analysing settlement services from the perspective of the issuers and also separately from the perspective of the participants.

Impacts of the proposed policies

Option 1	*Consider the substantial importance of a CSD by analysing settlement services from the **perspective of the issuers***
Benefits	The settlement activities of a CSD from one Member State may be of substantial importance for the functioning of the securities markets in another Member State if the CSD from the home Member State settles a significant amount of securities issued by issuers from the host Member State. Therefore this indicator provides a useful indication of substantial importance.
Costs to regulator:	There are no obvious differences in terms of the costs to the regulator

- *One-off* - *On-going*	for options 1 and 2. The costs may be slightly higher for option 3, as option 3 could potentially trigger more cooperation arrangements.
Compliance costs: - *One-off* - *On-going*	The CSD would need to record data regarding There are no obvious differences in terms of the compliance costs for CSDs for options 1 and 2. The costs may be slightly higher for option 3, as under option 3, CSDs would have to record and transmit information on settlement instructions based on the country of incorporation of the issuers of those securities, as well as based on the country of incorporation of the participants that settled those instructions.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	*Consider settlement services from a **participants' perspective** in a securities settlement system operated by a CSD*
Benefits	Allows for investor CSD activity to be captured, provides a more accurate representation of whether the activity is substantially important. A CSD does not normally have the necessary information on the indirect provision of settlement services (i.e. to indirect participants or to end investors) and it is problematic to compute such a calculation. Participants of the host Member State would be a proxy for investors and should help ensure there is consideration of the protection of investors in the host Member State.
Costs to regulator: - *One-off* - *On-going*	There are no obvious differences in terms of the costs to the regulator for options 1 and 2. The costs may be slightly higher for option 3, as option 3 could potentially trigger more cooperation arrangements.
Compliance costs: - *One-off* - *On-going*	There are no obvious differences in terms of the compliance costs for CSDs for options 1 and 2. The costs may be slightly higher for option 3, as under option 3, CSDs would have to record and transmit information on settlement instructions based on the country of incorporation of the issuers of those securities, as well as based on the country of incorporation of the participants that settled those instructions.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 3	*Consider the substantial importance of settlement services by analysing settlement services **from the perspective of the issuers and also separately from the perspective of the participants**.*

Benefits	This option has all the benefits of option 1 and option 2. It provides supervisory authorities with a broad understanding of the substantial importance of a CSD for all those parties (issuers and participants) in connection to settlement services.
Costs to regulator: - *One-off* - *On-going*	There are no obvious differences in terms of the costs to the regulator for options 1 and 2. The costs may be slightly higher for option 3, as option 3 could potentially trigger more cooperation arrangements.
Compliance costs: - *One-off* - *On-going*	There are no obvious differences in terms of the compliance costs for CSDs for options 1 and 2. The costs may be slightly higher for option 3, as under option 3, CSDs would have to record and transmit information on settlement instructions based on the country of incorporation of the issuers of those securities, as well as based on the country of incorporation of the participants that settled those instructions.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

The benefit of considering separate indicators that review a CSD's settlement services from both an issuers' perspective and also from the perspective of participants is highlighted in the above cost benefit analysis.

Most importantly the advantage of the third option for gauging the investor activities is apparent. It ensures that settlement services are fully investigated and decisions on substantial importance take into account a broader range of perspectives on CSD activities.

2.7 Law Governing the Securities Settlement System operated by a CSD

How should a CSD operating a securities settlement system that is governed by the law of another Member State be treated?

Specific Objective	**Ensure the correct CSDs are being caught and regarded as substantially important in host Member States**
Option 1	Take the stance that if a CSD operates a securities settlement system (SSS) that is governed by the law of another Member State, that CSD should be considered as substantially important for the functioning of the securities markets and the protection of the investors in that host Member State.
Option 2	A CSD should not be regarded as substantially important in a host Member State for the single reason that it operates a SSS that is governed by the law of another Member State
Preferred	**Option 1** – this option ensures that investors receive the most effective

Option	protection. It ensures the appropriate authorities have a responsibility to supervise the CSD in situations where it operates a SSS governed by another Member State's laws.

Impacts of the proposed policies

Option 1	*Take the stance that if a CSD operates a SSS governed by the law of another Member State, that CSD should be considered as substantially important for the functioning of the securities markets and the protection of the investors in that host Member State.*
Benefits	This option ensures investors are afforded the maximum protection, given the importance of the law governing the SSS.
Costs to regulator: - *One-off* - *On-going*	There will be costs for the authorities in the host Member States who are expected to contribute to the supervision of the accordingly substantial CSDs. However, in practice the authorities are already involved in cooperation arrangements in the case where a CSD operates a SSS governed by the law of another Member State.
Compliance costs: - *One-off* - *On-going*	There will be compliance costs for CSDs that are captured by this indicator. These costs will relate to the costs associated with communicating with additional authorities. However, these costs will be mitigated through the use of cooperation arrangements established by the authorities, which should streamline the supervision process and supervisory requests.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	*A CSD should not be regarded as substantially important in a host Member State for the single reason that it operates a SSS that is governed by the law of another Member State*
Benefits	This option will ensure that there is clear ownership by competent authorities with regard to supervising the compliance of a CSD.
Costs to regulator: - *One-off* - *On-going*	There will be fewer costs to the regulator if this option is selected because the CSD will not be accountable to multiple competent authorities.
Compliance costs: - *One-off* - *On-going*	There will be no additional compliance costs if this option is selected.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

2.8 Specialisation of a CSD in a specific type of financial instrument and/or in a specific type of securities transaction

This section assesses the impacts of the different options available for considering how a CSD's substantial importance should be considered in the event that the CSD concentrates activities on a specific type of financial instrument and/or type of securities transaction. There is a possibility that the CSD will therefore be of substantial importance for these types of transaction at a European Union level as well as at National level.

Should assessments be made that consider significance by focusing on specific types of financial instruments/specific types of securities transactions?

Specific Objective	**To ensure a proportionate approach is taken to assessing the substantial importance of CSDs which specialise in a specific type of financial instrument and/or in a specific type of securities transaction.**
Option 1	Do not make assessments of significance by focusing on specific types of financial instruments/specific types of securities transactions.
Option 2	Make assessments of significance by focusing on specific types of financial instruments and/or specific types of securities transactions.
Preferred Option	**Option 1** – it is important to make decisions on CSD significance without splitting various indicators according to the type of financial instrument or type of transaction.

Impacts of the proposed policies

Option 1	*Do not make assessments of significance by focusing on specific types of financial instruments/specific types of securities transactions*
Benefits	Avoids a complex and unmanageable process that results from the multiplication of indicators that would need to be collected and regularly assessed by competent authorities. Splitting activity by type of financial instrument would be a risk, even if the CSD is important for a specific type of financial instrument and/or type of securities transaction with respect to securities markets or investors of the host Member State it may not be of substantial importance in that host Member State in general.
Costs to regulator: - *One-off* - *On-going*	Costs for the regulator related to this option would be minimal. The distinction as to whether a CSD was substantial or not would not be further complicated by a requirement to make consideration based on specific securities or transaction type information.
Compliance costs: - *One-off* - *On-going*	This option would not create any additional compliance costs for CSDs. Internal monitoring of substantial importance will be a simpler process than it would be according to option 2, as only one threshold level for each indicator will be relevant for all securities and types of

	transactions.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	*Make assessments of significance by focusing on specific types of financial instruments and/or specific types of securities transactions*
Benefits	This option might lead to a higher number of CSDs being determined as being of substantial importance. Therefore, for investors making investments in the specific types of securities or types of transactions, there may be a heightened level of protection.
Costs to regulator: - *One-off* - *On-going*	Regulators would be required to analyse the spectrum of securities and types of transactions to determine the substantial importance of a CSD, which is time consuming and costly.
Compliance costs: - *One-off* - *On-going*	Compliance costs for CSDs will be greater than for option 1, as they will have to record and report more granular data for the calculation of the indicators.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Even if the CSD is important for a specific type of financial instrument and/or type of securities transaction with respect to securities markets or investors of the host Member State it may not be of substantial importance in that host Member State in general.

For example, if a CSD were specialised in the initial recording, central maintenance and/or settlement of one specific type of financial instrument, and/or type of securities transaction which did not signify a major part of the overall recording, central maintenance and/or settlement in that state, then the CSD should not be considered as substantially important for the securities market and/or investors of the host Member State.

Therefore ESMA believes that it is most appropriate to evaluate the substantial importance of CSDs with respect to the functioning of the securities markets and protection of the investors of a host Member State on a global basis, without splitting the various indicators according to the type of financial instruments of type of transactions.

2.9 The approach with regard to collateral management services

Should collateral management services be considered as an indicator of substantial importance?

Specific Objective	**Ensure that the correct CSD functions are considered when determining those that represent a certain countries importance to a host Member State CSD**
Option 1	Do not include collateral management services in the assessment of a CSD's substantial importance.
Option 2	Include collateral management services in the assessment of a CSD's substantial importance.
Preferred Option	**Option 1** - do not include collateral management services in the assessment of a CSD's substantial importance.

Impacts of the proposed policies

Option 1	*Do not include collateral management services in the assessment of a CSD's substantial importance.*
Benefits	Level playing field. These services are often provided by other entities, not only by CSDs. There are also occasions when the collateral management services are captured in the scope of settlement services – and so this would be reflected by the substantial importance criteria for settlement services and so the benefit of not including this assessment would be to avoid duplication.
Costs to regulator: - *One-off* - *On-going*	There will be no additional costs if these services are not included in assessments of substantial importance.
Compliance costs: - *One-off* - *On-going*	There will be no additional costs if these services are not included in assessments of substantial importance.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	*Include collateral management services in the assessment of a CSD's substantial importance.*
Benefits	Ensures a complete picture of the CSD's functions including this ancillary service which complements the settlement services.
Costs to regulator: - *One-off* - *On-going*	There will be additional costs for the authorities in the host Member States who are expected to contribute to the supervision of the accordingly substantial CSDs.
Compliance costs: - *One-off* - *On-going*	Potential unlevel playing field, both one-off and on-going cost associated to this. There would be associated costs for CSDs relating to the internal systems they have in place to monitor collateral management operations, and the collection and reporting of related data for the calculation of the indicator. Once they are caught by this

	indicator then there will be additional compliance costs, relating to communicating with regulators and reporting to additional regulators. However, these costs will be mitigated through the use of cooperation arrangements established by the authorities, which should streamline the supervision process and supervisory requests.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

The majority of collateral management services would already be captured in the scope of the settlement services and therefore the substantial importance criteria for settlement services would reflect this.

However there would be instances where this service wouldn't be covered by settlement service, for example, where a pledge has been made. At the same time, collateral management services can be provided by non-CSD entities (e.g. custodians, investment firms, etc.).

Respondents to the ESMA consultation supported the ESMA decision not to include collateral management services in the assessment of the threshold for the central maintenance service.

2.10 The approach with regard to branches of a CSD established in host Member States

What approach should be taken to considering the substantial importance of a branch?

Policy Objective	**Ensure appropriate assessments are made with regard to branches established in host Member States**
Option 1	Automatically include branches as substantially important CSDs in host Member States.
Option 2	Do not automatically include branches as substantially important CSDs, instead only rely on the same criteria other CSDs are assessed with when assessing the substantial importance of a CSD that is a branch.
Preferred Option	**Option 2** – Do not automatically include branches as substantially important CSDs, instead only rely on the same criteria other CSDs are assessed with when assessing the substantial importance of a CSD that is a branch.

Impacts of the proposed policies

Option 1	*Automatically include branches as substantially important CSDs in host*

	Member States
Benefits	Establishing a branch in a host Member State indicates a physical presence which could be interpreted as being of substantial importance. It is a concrete factor which does not require the calculation of additional indicators.
Costs to regulator: - *One-off* - *On-going*	Potentially increased costs if there are more CSDs that would be captured by this, which would not otherwise be captured under the other indicators.
Compliance costs: - *One-off* - *On-going*	Once they are caught by this indicator then there will be additional compliance costs, relating to communicating with regulators and reporting to additional regulators. However, these costs will be mitigated through the use of cooperation arrangements established by the authorities, which should streamline the supervision process and supervisory requests.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.
Indirect costs	None

Option 2	Do not automatically include branches as substantially important CSDs, instead only rely on the same criteria other CSDs are assessed with when assessing the substantial importance of a CSD that is a branch.
Benefits	Simply because a CSD establishes a branch in a host Member State and has a physical presence, the activity of the CSD in a host Member State is not necessarily of substantial importance. There is no guarantee that the branch's existence will lead to significant activity. If the activity is not substantial, the physical presence *per se* should not be considered as a criterion. If a branch does generate significant activity of a CSD in the host Member State and it is substantially important, this will be captured under one of the other indicators included in the technical advice. Therefore the benefit of this option is that it will save resource from a regulatory and a compliance perspective, as the other indicators sufficiently capture the CSDs of substantial importance.
Costs to regulator: - *One-off* - *On-going*	This option does not create additional costs for the regulator.
Compliance costs: - *One-off* - *On-going*	This option does not create any additional compliance costs.
Costs to other stakeholders	Other stakeholders are not impacted by either of the options.

Indirect costs	None

ESMA believes that simply because a CSD establishes a branch in a host Member State and has a physical presence, the activity of the CSD in a host Member State is not necessarily of substantial importance. There is no guarantee that the branch's existence will lead to significant activity, and so to automatically classify all branches as significantly important CSDs would be overly burdensome on both regulators and also CSDs.

If a branch does generate significant activity of a CSD in the host Member State and it is substantially important, this will be appropriately captured under one of the other indicators included in the technical advice which mitigates the risk of not meeting the objectives of the measure of substantial importance.