



European Securities and
Markets Authority

Report to the European Commission

CSDR Internalised Settlement

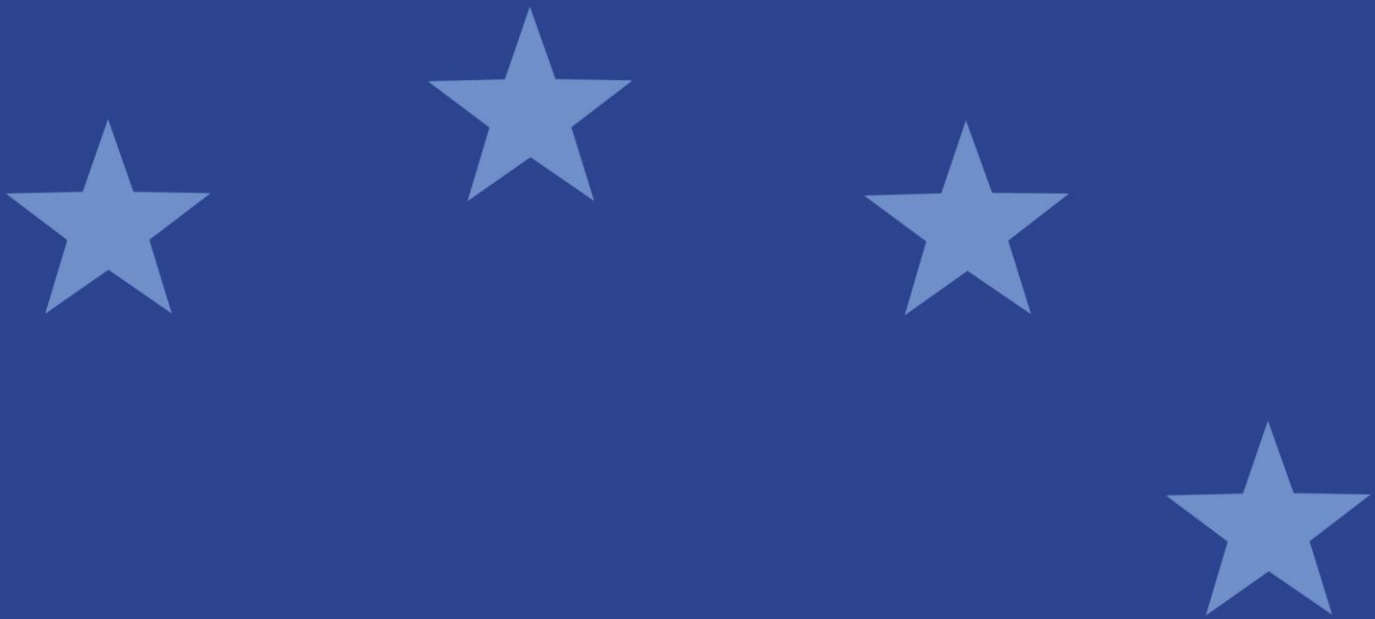


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Executive Summary

Reasons for publication

According to Article 74 of CSDR, ESMA shall, in cooperation with EBA and the competent authorities and the relevant authorities, submit annual reports to the European Commission on the implementation of CSDR, including assessments of trends, potential risks and vulnerabilities, and, where necessary, recommendations of preventative or remedial action.

The present Report covers internalised settlement in accordance with Article 74(1)(c) of CSDR, by assessing the extent of the settlement activity in the EEA which does not take place through a securities settlement system, based on the data reported by settlement internalisers under Article 9 of CSDR. The Report analyses the trends and potential risks related to internalised settlement, as well as the process for internalised settlement reporting under CSDR.

Contents

The present Report is structured in 6 Sections and 2 Annexes.

Section 1 describes the background for this exercise.

Section 2 sets out the scope and focus of the report.

Section 3 details the sources of information used for the analysis in the report.

Section 4 covers the findings related to internalised settlement, taking into account the responses to the ESMA survey on internalised settlement, and the input from NCAs based on their ongoing supervision activities.

Section 5 includes an analysis of the internalised settlement data based on the quarterly reports sent by settlement internalisers according to Article 9 of CSDR covering the period **Q2 2019 – Q3 2020**.

Section 6 presents the conclusions.

As far as the Annexes are concerned, Annex I includes the ESMA survey on internalised settlement used as the baseline for the preparation of this Report, while Annex II provides the list of respondents to the ESMA survey and contributors to this Report.

Conclusions

No major risks have been identified during the period covered by the Report. NCAs have however identified some risks, the most common being operational risk and custody risk. In terms of measures to mitigate those risks, ESMA would like to refer to the adequate

identification of the clients' accounts involved, and the improvement of the operational processes.

The challenges encountered when implementing the internalised settlement reporting regime seem normal in terms of any new reporting requirements. To support the implementation process, ESMA has provided additional clarifications through supervisory convergence measures, including the ESMA Guidelines on internalised settlement reporting, as well as Q&As.

Given that this is a new reporting regime, and that data quality checks are still ongoing, it is acknowledged that data covering a longer period of time would be needed in order to have a clearer picture regarding internalised settlement trends. At the same time, it is useful to use the existing data to set a benchmark for future assessments.

ESMA would like to highlight the importance of continuing to monitor internalised settlement, in order to assess if this activity should be regulated in the future, in particular considering the extremely high values and volumes of internalised settlement, as well as the high level of concentration shown by the data reported by settlement internalisers under Article 9 of CSDR. ESMA believes that, as a minimum, custodians' clients should be informed of the risks and costs associated with the place of settlement (at the level of a securities settlement system operated by a CSD versus internalised settlement).

Legislative references

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 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
Settlement Finality Directive	Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems
Directive 2014/65/EU	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
Directive 2013/36/EU	Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC
Directive 2009/65/EC	Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)
RTS on internalised settlement	Commission Delegated Regulation (EU) 2017/391 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards further specifying the content of the reporting on internalised settlements
ITS on internalised settlement	Commission Implementing Regulation (EU) 2017/393 of 11 November 2016 laying down implementing technical standards with regard to the templates and procedures for the reporting and transmission of information on internalised settlements in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council
RTS on settlement discipline	Commission Delegated Regulation (EU) 2018/1229 of 25 May 2018 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline

Acronyms

CSD	Central securities depository
EC	European Commission
ESMA	European Securities and Markets Authority
EEA	European Economic Area
EU	European Union
NCA	CSD National Competent Authority
SetIn	Settlement internaliser
SSS	Securities settlement system

1. Background

1. According to Article 74 of CSDR, ESMA shall, in cooperation with EBA and the competent authorities and the relevant authorities, submit annual reports to the European Commission providing assessments of trends, potential risks and vulnerabilities, and, where necessary, recommendations of preventative or remedial action in the markets for services covered by CSDR.
2. One of the topics which has to be covered in accordance with Article 74(1)(c) is internalised settlement: “*measuring settlement which does not take place in the securities settlement systems operated by CSDs based on the number and volume of transactions based on the information received under Article 9 and any other relevant criteria*”.

2. Scope

3. The scope of this Report focuses on the internalised settlement reporting regime and data, taking into account the input received from NCAs and trade associations regarding the implementation of the reporting regime, as well as an analysis of the internalised settlement data submitted to the EEA¹ NCAs and ESMA covering the period **1 April 2019² to 30 September 2020**, with a cut-off date for the reports submitted to ESMA by 20 October 2020.

3. Sources of information

4. This ESMA Report takes into account: a) the input received from CSD National Competent Authorities (NCAs), AFME and EBF in response to an ESMA survey on internalised settlement conducted in June-July 2020, and b) the internalised settlement reports received by NCAs and submitted to ESMA in accordance with Article 9 of CSDR. When responding to the ESMA survey, the CSD NCAs were encouraged to liaise with the authorities supervising settlement internalisers (e.g. banking supervisors), in case they are different from the CSD NCA.

4. Findings – internalised settlement (general analysis)

5. This Section covers the findings related to internalised settlement taking into account the responses to the ESMA survey on internalised settlement, and the input from NCAs based on their ongoing supervision activities. ESMA has received responses to the survey on internalised settlement and input for this Report from 26 NCAs and 2 trade associations (please see the list in Annex II).

¹ The references to 'EEA' should be read as references to 'EEA30', without the UK, given the Brexit context.

² Beginning of the application of the internalised settlement reporting requirements: first internalised settlement reports sent in July 2019, covering Q2 2019 (April-June 2019).

4.1 Introduction

6. According to Article 9(1) of CSDR, settlement internalisers shall report to the NCAs of their place of establishment on a quarterly basis the aggregated volume and value of all securities transactions that they settle outside securities settlement systems. NCAs shall, without delay, transmit the information received to ESMA and shall inform ESMA of any potential risk resulting from that settlement activity.
7. A settlement internaliser is defined in Article 2(1)(11) of CSDR as any institution, including one authorised in accordance with Directive 2013/36/EU or with Directive 2014/65/EU, which executes transfer orders on behalf of clients or on its own account other than through a securities settlement system.
8. Internalised settlement can happen at different levels of a securities holding chain (global custodians, sub-custodians, etc.), and it should be reported at the level where it takes place. Each settlement internaliser should be responsible for reporting the settlement that has been internalised in its books only.
9. A settlement internaliser should send the following reports to the NCA in the EEA State where it is established:
 - a) one report for its activity in the EEA State where it is established (including the activity of its branches in that EEA State);
 - b) separate reports for the activity of its branches per EEA State (if applicable);
 - c) one report for the activity of its branches in third countries (if applicable).
10. The scope of Article 9 of CSDR covers all financial instruments eligible for settlement in a securities settlement system operated by an EEA CSD and/or designated under the law of an EEA State under the Settlement Finality Directive, including financial instruments which may have been initially recorded or centrally maintained with an entity that may not necessarily be a CSD, such as a registrar or a transfer agent.
11. The Commission Delegated Regulation (EU) 2017/391 (RTS on internalised settlement) further specifies the content of the internalised settlement reporting, while the Commission Implementing Regulation (EU) 2017/393 (ITS on internalised settlement) specifies the templates and procedures for the reporting and transmission of information on internalised settlement.
12. In order to ensure the common, uniform and consistent application of Article 9 of CSDR, ESMA has published Guidelines on internalised settlement reporting and on the exchange of information between the competent authorities and ESMA regarding internalised settlement³, as well as Q&As on internalised settlement⁴.

³ Please see the following link: <https://www.esma.europa.eu/document/guidelines-internalised-settlement-reporting-under-article-9-csdr-0>

⁴ Please see the following link: https://www.esma.europa.eu/sites/default/files/library/esma70-708036281-2_csd_r_qas.pdf

13. Settlement internalisers have to submit the reports in an XML format, according to the ISO 20022 compliant XSD message⁵ published by ESMA.

4.2 Risks related to internalised settlement

14. No major risks related to internalised settlement have been identified during the period covered by the report (i.e. risks with a very high or high impact, and with a very high or high probability to materialise). Nevertheless, NCAs have identified some risks related to this activity, the most common being operational risk and custody risk. In terms of measures to mitigate those risks, ESMA would like to highlight the adequate identification of the clients' accounts involved, and the improvement of the operational processes.
15. As an example, it was noticed that some settlement internalisers had erroneous internalised settlement instructions pending for a very long time in their books (which became apparent in the context of high rates of settlement fails reported). The respective instructions were subsequently corrected.
16. One trade association mentioned the need to carefully monitor the management of positions within omnibus accounts at the level of settlement internalisers, as a measure to address operational risk.
17. Other risks that are monitored are the risk that the volume and/or value of internalised settlement instructions increase over time, as well as the concentration risk.
18. One trade association also referred to the legal risk of settlement internalisers misinterpreting the internalised settlement reporting requirements, and the need to liaise with the NCAs in this respect. ESMA would like to highlight the importance of supervisory convergence measures published in this context, such as the Guidelines on internalised settlement reporting and the Q&As on internalised settlement.
19. Data quality was also mentioned as an important element to ensure adequate procedures at the level of settlement internalisers and communication with the NCAs and ESMA.
20. Based on the NCAs' input, the likelihood of settlement moving away from CSDs to settlement internalisers following the entry into force of the CSDR settlement discipline regime ranges from: very low (4 responses), to low (6 responses) and medium (3 responses). According to the trade associations, the likelihood is very low (1 response) or low (1 response).
21. It should be mentioned that internalised settlement can only take place if both parties to a transaction are clients of the same entity (i.e. the settlement internaliser). An important question is if market participants have developed/ are developing a business model based on internalised settlement. According to information gathered by some NCAs within the

⁵ Please see the following link: <https://www.iso20022.org/message-set/741/download>

course of supervision, internalised settlement seems to be an accidental phenomenon in some jurisdictions. It happens when the settlement instruction is not forwarded to the CSD due to the set-up of the securities accounts. At the same time, ESMA notes the very high levels of internalised settlement (both in terms of value and in terms of volume of instructions) in several jurisdictions and also overall in the EEA, as well as the high level of concentration with some settlement internalisers accounting for a significant part of the internalised settlement activity. This should be further investigated by NCAs as part of the ongoing supervision.

4.3. Internalised settlement trends

22. ESMA acknowledges that data covering a longer period of time would be needed in order to have a clearer picture regarding internalised settlement trends. At the same time, it is important to use the existing data to set a benchmark for future assessments, with the caveat that there are still data quality checks ongoing and new submissions and corrections expected, given that this is a new reporting regime. Therefore, the trends and related data included in this first Report on this topic have to be considered with a degree of caution.
23. ESMA refers to Section 5 of this Report for more details regarding the internalised settlement data analysis and the preliminary assessment of possible trends.

4.4. Settlement internalisers typology

24. Settlement internalisers are usually credit institutions authorised in accordance with Directive 2013/36/EU, and investment firms authorised in accordance with Directive 2014/65/EU and, in some cases, management companies authorised in accordance with Directive 2009/65/EC.
25. It should be further investigated by NCAs as part of their ongoing supervision if there are entities that act as settlement internalisers and that are not financial institutions.

4.5 Encountered challenges regarding the implementation of the internalised settlement reporting requirements

26. This section reflects the encountered challenges regarding the implementation of the internalised settlement reporting requirements, according to the responses to the ESMA survey on internalised settlement.
27. Many NCAs have not identified any challenges regarding the reporting requirements, while several NCAs have mentioned that they were faced with some challenges as part of the implementation of this new reporting regime.
28. In the beginning of the reporting it was necessary to answer a number of general and technical questions from industry, such as clarifying the reporting scope, the type of instruments and operations subject to the reporting obligation.

29. In one jurisdiction, due to the broad definition of internalised settlement and the absence of a minimum threshold triggering the reporting obligation (risk-based approach), about 1,200 entities had to comply with the reporting requirements.
30. Reaching out to the market participants to inform them and identify if some of their activity might be classified as internalised settlement also proved challenging for some NCAs. Another related challenge that was mentioned by one NCA was ensuring that branch activity was reported correctly.
31. Most challenges seemed to be in connection to the technical implementation of the reporting regime, which required significant IT changes at the level of settlement internalisers as well as at the level of the NCAs and ESMA. Some of these challenges were: onboarding settlement internalisers to the NCAs' reporting systems, and uploading the reports onto the ESMA IT system, the correct implementation of the ISO 20022 XSD/XML format by settlement internalisers and the implementation of the numerous validation rules.
32. Last but not least, some NCAs mentioned the challenges to obtain a high quality of the reported data and the need to correct reporting mistakes made by small firms in particular.
33. Trade associations mentioned that, despite the development of a single reporting schema by ESMA, the method according to which settlement internalisers were asked to report to some NCAs differed; this lack of a harmonised approach created significant development complexities for firms required to report to multiple NCAs. There were differences in the timing and clarity of the information provided by NCAs, which created additional cost and complexities in firms' development projects.
34. Trade associations also referred to challenges related to determining the perimeter of instruments and operations to take into consideration for reporting. Another identified challenge was in relation to netting: due to sometimes numerous splits, it was found difficult to establish the connection from the original settlements to what was actually settled at the CSD and when, and what was left to be reported under the internalised settlement reporting regime.
35. Trade associations also mentioned difficulties related to obtaining information on the Issuer CSD identifier – since the Issuer CSD data are missing from the data providers. However they acknowledged that there is a work-a-round foreseen by the regulatory framework with use of the first two characters of the ISIN.
36. Trade associations also added that, when preparing for the go-live of reporting, the ESMA validation procedure (testing phase) was challenging, and they also noticed some differences between the User Acceptance Testing (UAT) environment used for testing the IT system, and the Production (PROD) environment, used once the IT system went live.
37. Another challenge mentioned by a trade association was in relation to the correction of reports following data quality checks.

38. As a general comment, ESMA would like to highlight that the encountered challenges seem normal for the implementation of any new reporting requirement (e.g. clarifying the scope, identifying the relevant population, developing and implementing the necessary IT tools and systems, ensuring data quality). To support the implementation process, ESMA has provided additional clarifications through supervisory convergence measures, including the ESMA Guidelines on internalised settlement reporting, as well as Q&As.

4.6 Suggestions for improving the process and regulatory recommendations

39. This section covers the suggestions for improving the internalised settlement reporting process received in response to the ESMA survey on internalised settlement. The majority of the respondents did not identify the need to improve the internalised settlement reporting process and/or the sharing of data amongst NCAs. The suggestions mentioned by some NCAs and trade associations are reflected below.

4.6.1 Suggestions potentially requiring a Level 1 or Level 2 change:

a) Proportionality approach

40. On the one hand, some NCAs called for a change of the Article 9 CSDR requirements by implementing a minimum level of internalised settlement value and/or volume regarding the reporting obligation. On the other hand, other NCAs pointed out that introducing a threshold might not necessarily alleviate the burden for small settlement internalisers given that settlement internalisers that are under the threshold would face the usual difficulties related to constant monitoring and uncertainty regarding whether to report if the threshold is crossed on a punctual basis.

41. One NCA suggested adopting a lower frequency for the reporting (e.g. each 4 months); and/or clarifying the scope of entities subject to reporting (credit institutions, investment firms and other entities (except CCPs) which have established a business model based on internalised settlement).

42. Regarding the proposal to implement a minimum level of internalised settlement value and/or volume regarding the reporting obligation, ESMA believes that the implications in terms of calibrating the thresholds, monitoring the thresholds both by the market participants and NCAs, as well as the already made investments by market participants to comply with the current regime should be carefully balanced.

43. As far as the proposal to lower the frequency, ESMA supports the current quarterly frequency for internalised settlement reporting. With this ESMA also considers the fact that, in terms of comparison, CSDs will be required to report settlement fails data on a monthly basis under the RTS on settlement discipline, with the possibility for NCAs to ask them to send more frequent reports and that CSDs are currently sending reports on a voluntary basis to NCAs which in turn send them to ESMA on a weekly basis.

44. ESMA does not support the proposal to limit the definition of settlement internalisers, as ESMA considers that one of the objectives of this reporting regime is to identify the population and typology of market participants that engage in this type of activity, in order to also assess if any identified risks are properly mitigated.

b) Risk assessment frequency

45. One NCA mentioned that a risk assessment every quarter does not provide much added value, given that figures are quite stable from one quarter to the other. They suggested amending Article 4(1) of the ITS on internalised settlement, so that the NCAs only submit the risk assessment to ESMA if the risk assessment shows any evolution of the risks resulting from the internalised settlement activity.

46. ESMA believes that the risk assessment should take place on a quarterly basis, given the very high volumes and values of internalised settlement reported, as well as the high rates of settlement fails. Moreover, it is important that the risk assessment is correlated with the frequency of the data received. In addition, considering that this is a new reporting regime, NCAs should also be incentivised to duly monitor this activity.

47. It should also be highlighted that, in terms of the practical communication of the risk assessment results by NCAs to ESMA, the ESMA dedicated IT system facilitates a simple process: NCAs can tick a box 'No risks identified', in case they have not identified any risks, and fill in an online form if risks have been identified; if there are no changes compared to the previous quarter, this can be reflected in the online form.

c) Scope

48. A few NCAs made suggestions regarding the scope of the internalised settlement reporting regime, which are mentioned below:

- 1) clarifying that transfers between same client accounts in the same entity should not be considered as being in scope;
- 2) clarifying if free of payment internalised settlement instructions related to inheritance should be in scope of the reporting regime;
- 3) the scope of entities subject to reporting should be limited to credit institutions, investment firms and other entities (except CCPs) which have established a business model based on internalised settlement).

49. Regarding the first proposal, ESMA would like to highlight that transfers between same participant accounts are not exempted in the case of settlement in the securities settlement systems operated by CSDs. Therefore, ESMA considers that they should not be exempted in the case of internalised settlement either.

50. As far as the second proposal is concerned, ESMA's view is that, according to the current regulatory regime, settlement instructions related to inheritance seem to be in scope. This could potentially be clarified through a Q&A by the European Commission, and also

something that could be considered once a revision of the ITS on internalised settlement will take place.

51. Regarding the third proposal, ESMA does not support the proposal to limit the definition of settlement internalisers, as ESMA considers that one of the objectives of this reporting regime is to identify the population and typology of market participants that engage in this type of activity, in order to also assess if any identified risks are properly mitigated.

d) Volume/number of instructions

52. One NCA suggested adding 'number of transactions' in 'volume' cells in Annex I to the ITS on internalised settlement, given that ESMA data quality checks have revealed that too many settlement internalisers misunderstood the notion of "volume" to report.
53. ESMA's view is that this is something to be considered once a revision of the ITS on internalised settlement will take place. It should also be highlighted that this is already clarified in para. 21 of the ESMA Guidelines on internalised settlement reporting, according to which "volumes should be expressed in the number of internalised settlement instructions".

e) Issuer CSD LEI

54. One trade association asked for the requirement to report data based on the Issuer CSD LEI to be removed from the ITS on internalised settlement, since the information on which CSD is the Issuer CSD is not available and is not likely to become available in the near future. According to this trade association, they have contacted several data providers on this topic, and no one has so far been able to provide this data and it is not likely that they will be able to do so in the future because the data service would be very expensive as this data is currently only used for internalised settlement reporting.
55. ESMA understands that the problem is for settlement internalisers to identify who the Issuer CSD is for specific financial instruments. ESMA's view is that this should be further assessed. This would also have an impact on the related requirement in the RTS on internalised settlement. ESMA considers that this is not a significant change, since this Regulation already foresees the possibility for settlement internalisers to use the first two characters of the ISIN, in case the information about the Issuer CSD is not available.
56. Moreover, through the ESMA Guidelines on internalised settlement (para. 19), it is clarified that competent authorities should ensure that settlement internalisers include the first two characters of the ISINs in the reports in all cases, not just as a fallback solution in case the Issuer CSD cannot be identified by the settlement internalisers. This could potentially be included in the RTS on internalised settlement. In the meantime, ESMA would like to encourage data vendors to make this information publicly available.

4.6.2 Suggestions potentially requiring a change of the ESMA Guidelines on internalised settlement reporting:

Approach for reporting failed internalised settlement instructions

57. Some NCAs and trade associations have suggested reconsidering the approach specified in para. 22 of the ESMA Guidelines on internalised settlement reporting, according to which if an internalised settlement instruction fails to settle for several days after the intended settlement date (ISD), including in the case where the settlement instruction is cancelled, then it should be reported as “failed” by taking into account each day when it fails to settle. According to one NCA, this requirement to report a trade as failed per day pending client action, leads to a number of failed trades being reported from a single distinct trade. This inflates the overall level of failed trades reported and makes it more difficult for NCAs to isolate distinct failed trades and compare them to the settled trades. It may be more useful to report failed trades once and include a separate category of reporting indicating the settlement timeframe for each failed trade. The output from settlement fails reporting should be consistent and comparable with the standard reporting from CSDs. In turn, settlement internaliser metrics should be compared to similar CSD metrics to identify if settlement internaliser activity has an impact on real settlement through a CSD.

58. ESMA would like to highlight that, according to the approach foreseen in para. 22 of the ESMA Guidelines on internalised settlement reporting (included below), internalised settlement instructions should also be counted in the total instructions for each business day until they are settled. This approach is consistent with the approach foreseen for settlement fails reporting by CSDs under the RTS on settlement discipline (which includes the requirement for CSDs to report daily data). Further discussions on this topic can take place in the context of ESMA’s current work on Guidelines on settlement fails reporting by CSDs.

22. If during a quarter covered by a report, an internalised settlement instruction fails to settle for several days after the intended settlement date (ISD), including in the case where the settlement instruction is cancelled, then it should be reported as “failed” by taking into account each day when it fails to settle. It should be reported as “settled” if it is settled during the quarter covered by the report.

Please see the following example: If during the quarter covered by the report an internalised settlement instruction with a value of 100 euros fails to settle for 3 days, and then it is settled, it should be reported as follows (considering double side reporting):

Settled		Failed		Total	
Volume	Value (EUR)	Volume	Value (EUR)	Volume	Value (EUR)
2	200	6	600	8	800

4.6.3 Suggestions for improving the process (not requiring any changes to the current regulatory framework):

a) NCAs' feedback for settlement internalisers

59. One trade association mentioned that a response or evaluation from the NCAs to the reporting settlement internaliser would be welcome. A feedback or comments on the reports could also help enhance the reporting process and quality.
60. ESMA believes that this would be beneficial in terms of supervisory practices. Some NCAs mentioned that they already provide feedback when settlement internalisers ask questions or when reports are rejected after the official submission deadline. One NCA highlighted that an evaluation from the NCA could be provided upon a settlement internaliser's request.

b) Data publication

61. One trade association has mentioned that they would welcome having access to aggregated and anonymised data gathered by NCAs. This would be very insightful, not only for internal firm purposes, but also for benchmarking with the wider industry and for the development and refinement of market practices.
62. Currently there are no requirements for ESMA to publish specific data on internalised settlement. ESMA believes that the charts and data published in this Report should provide a good insight.

4.6.4 Should internalised settlement be regulated?

63. Regarding whether or not internalised settlement should be regulated, the majority of NCAs did not express an opinion or said that it should not be regulated as such regulation would put additional burden and costs on the market participants which may in turn increase costs of transactions.
64. According to a few NCAs, internalised settlement should be regulated. One NCA considered that, if regulation should come, a minimum threshold for the volume and value reported should be set up, in order to capture only the biggest custodian banks as they cover the majority of the internalised settlement activity.
65. According to one NCA, all settlement activities regulated in CSDR should be regulated if performed by other entities, based on the principle same activities, same rules (taking into consideration the scale of internalised settlement carried out by each particular entity). Another suggestion put forth by the same NCA refers to the settlement finality of internalised settlement (given that custodians' clients will not always know whether their instructions are going to be internalised or not, so they may be more or less covered depending on a decision they have not made).

66. One NCA believes that the internalised settlement activity should be monitored and, if an increasing trend in internalised settlement (a shift from CSD settlement) is detected, especially if it is accompanied by a rise in settlement fails, then a new regime should be considered.
67. ESMA agrees with the importance of continuing to monitor internalised settlement, in order to assess if this activity should be regulated, in particular considering the extremely high values and volumes of internalised settlement according to the reports submitted by settlement internalisers under Article 9 of CSDR. ESMA believes the argument regarding settlement finality is a valid one, and, as a minimum, custodians' clients should be informed of the risks and costs associated with the place of settlement (at the level of a securities settlement system operated by a CSD versus internalised settlement).

5. Findings - internalised settlement data analysis

68. Starting with Q2 2019, according to Article 9(1) of CSDR, settlement internalisers have to report to the NCAs of their place of establishment on a quarterly basis the aggregated volume and value of all securities transactions that they settle outside securities settlement systems. NCAs have to transmit the reports received to ESMA and have to inform ESMA of any potential risk resulting from that settlement activity.
69. The internalised settlement data based on the quarterly reports sent by settlement internalisers shows very high volumes and values, high concentration, as well as high settlement fail rates. This proves the importance of monitoring the internalised settlement activity.
70. ESMA refers to the internalised settlement data and charts based on the internalised settlement reports received by ESMA from NCAs as submitted by settlement internalisers under Article 9 of CSDR from EEA⁶ States. The data covers the period: **Q2 2019 – Q3 2020**, with a cut-off date for the reports submitted to ESMA by **20 October 2020**.
71. It should also be mentioned that ESMA has not yet received any internalised settlement reports from settlement internalisers from Bulgaria and Greece. It is expected that, when settlement internalisers from Bulgaria and Greece start reporting, they should send the quarterly reports as of Q2 2019, in line with the official date of application of this reporting regime.
72. The CSDR Level 2 Regulations (including the RTS and ITS on internalised settlement) have not yet been incorporated into Icelandic law and, therefore, the internalised settlement reporting requirements are not yet applicable in Iceland.
73. As previously mentioned, we acknowledge that data covering a longer period of time would be needed in order to have a clearer picture regarding internalised settlement trends. At the same time, it is important to use the existing data to set a benchmark for future assessments, with the caveat that there are still data quality checks ongoing and new

⁶ The references to 'EEA' should be read as references to 'EEA30', without the UK, given the Brexit context.

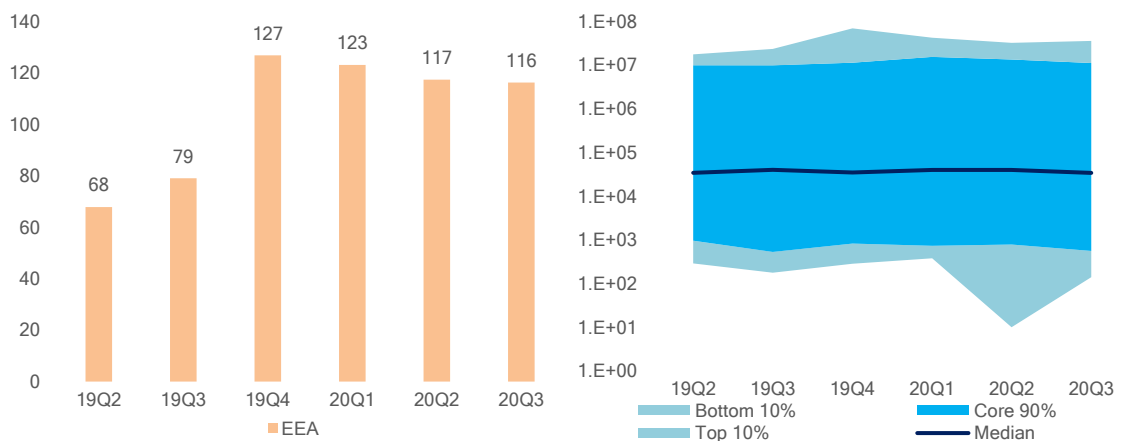
submissions and corrections expected, given that this is a new reporting regime. Therefore, the trends and related data included in this first ESMA Report on this topic have to be considered with some caution.

5.1 Internalised settlement risk indicators

74. ESMA together with the NCAs has developed a set of risk indicators in order to support the monitoring of internalised settlement. Below ESMA provides a first overview of these risk indicators.

1. Number (millions) of internalised settlement instructions per reporting quarter (EEA)

- ESMA notices an increase in the number of internalised settlement instructions at EEA level.
- The total internalised settlement volume per EEA State is very dispersed, ranging from several hundred instructions in some cases to tens of million instructions for the jurisdictions with more internalised settlement activity. However, it remains relatively stable over time as demonstrated by the evolution of the width and levels displayed in the dispersion chart below (i.e. Bottom 10%, Core 90%, Top 10% and Median).
- While ESMA acknowledges that not all settlement internalisers may have used this approach (given the ongoing data quality checks), it is expected that settlement internalisers have counted each separate internalised settlement instruction in the aggregate figures (i.e. double side reporting), and that they have reported the instructions by taking into account each business day until they are settled, according to the ESMA Guidelines on internalised settlement reporting. Please see Section 5.2 for more details.
- It's important to bear in mind that Q2 and Q3 2019 figures may be more impacted than 2020 figures by data quality issues such as entities not reporting data or misreporting, given that data quality has improved with the more recent reports.



Note: Total number of internalised settlement instructions per reporting quarter in the EEA, in millions.
Sources: ESMA.

Note: Dispersion of the total number of internalised settlement instructions per EEA State per reporting quarter. Displayed using a logarithmic scale.
Sources: ESMA.

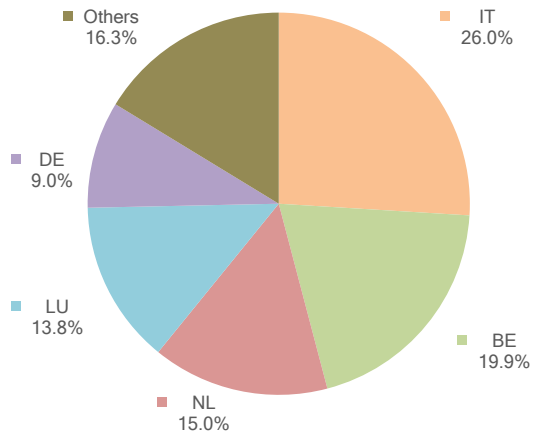
- The breakdown per EEA State in terms of the number of internalised settlement internalised settlement instructions per quarter is included below.

EEA States ⁷	Total number of internalised settlement instructions					
	2019			2020		
NCA	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
AT	202,521	535,463	490,740	348,474	298,471	326,425
BE	13,528,646	23,535,600	69,632,857	42,582,609	32,427,186	33,058,343
CY	174,502	237,405	195,906	209,087	144,488	135,079
CZ	17,437	16,931	16,981	36,511	29,100	11,308
DE	6,139,438	6,602,025	11,958,101	21,630,335	32,178,519	35,906,724
DK	55,568	52,813	41,112	107,520	90,197	49,161
EE	1,703	1,000	828	773	706	570
ES	43,547	40,954	44,843	46,890	32,529	35,030
FI	6,138	3,269	2,569	35,291	398,233	494,626
FR	4,953,726	4,824,629	5,374,628	6,583,435	6,145,572	6,039,590
HR	288	176	282	488	984	552
HU	25,327	40,157	70,179	56,959	46,508	19,671
IE	739,117	838,982	857,225	1,047,340	1,024,616	866,964
IT	17,630,917	17,924,403	15,777,275	17,451,631	13,293,504	11,062,232
LI				19,252	16,117	14,503
LT	4,198	2,841	2,854	1,472	1,192	1,494
LU	9,373,865	8,911,106	6,711,991	7,118,733	6,461,612	7,046,337
LV	747	329	522	377	558	140
MT	1,440	829	877	677	831	281
NL	10,151,203	10,526,505	10,757,963	11,492,762	10,830,851	11,495,984
NO			28,796	40,075	39,923	33,316
PL		6,010	6,192	4,709	3,393	5,519
PT	12,361	11,724	14,512	12,128	9,418	9,501
RO	7,099	3,080	2,698	4,445	3,336	2,380
SE	4,800,348	4,974,497	4,842,610	14,218,079	13,904,791	9,649,927
SI	539	204	808	952	10	
SK	11,236	11,762	12,588	11,043	10,986	11,365
Total EEA	67,881,911	79,102,694	126,845,937	123,062,047	117,393,631	116,277,022

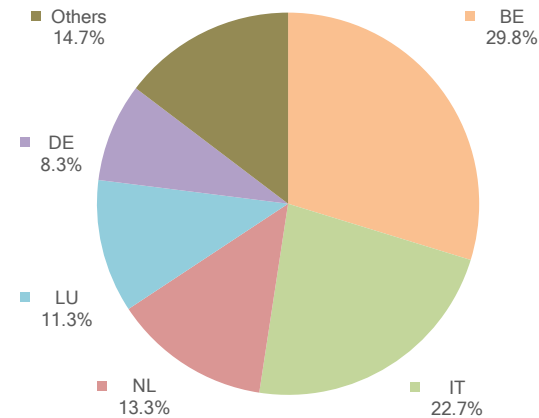
⁷ The NCAs from Bulgaria and Greece have not yet submitted internalised settlement reports from settlement internalisers in their jurisdiction to ESMA. The CSDR Level 2 Regulations have not yet been incorporated into Icelandic law and, therefore, the internalised settlement reporting requirements are not yet applicable in Iceland. UK data is not included, given the Brexit context.

2. Top 5 EEA States in the total number of internalised settlement instructions per reporting quarter

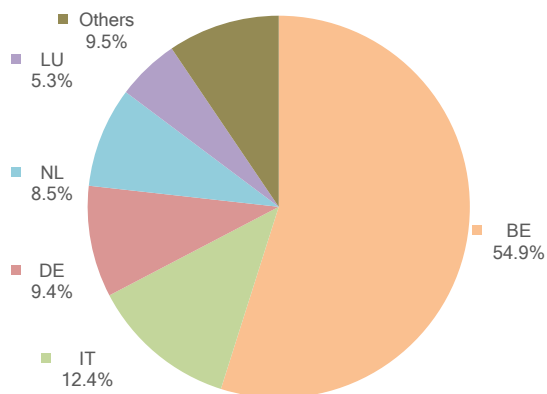
- It's important to bear in mind that Q2 and Q3 2019 figures may be more impacted than 2020 figures by data quality issues such as entities not reporting data or misreporting, given that data quality has improved with the more recent reports.



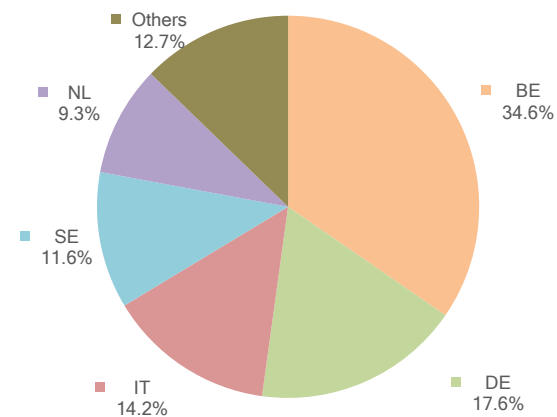
Note: Share of the top 5 EEA States and all others combined, out of the total number of internalised settlement instructions in the EEA as of 19Q2.
Sources: ESMA.



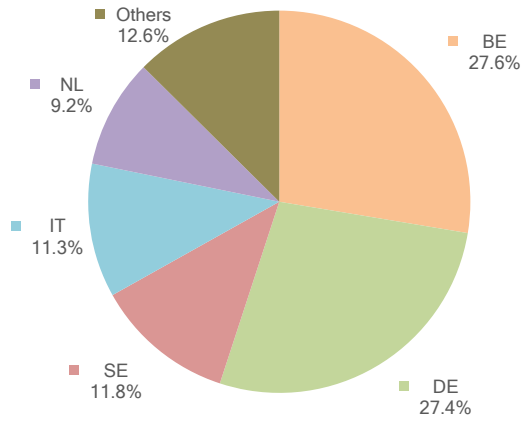
Note: Share of the top 5 EEA States and all others combined, out of the total number of internalised settlement instructions in the EEA as of 19Q3.
Sources: ESMA.



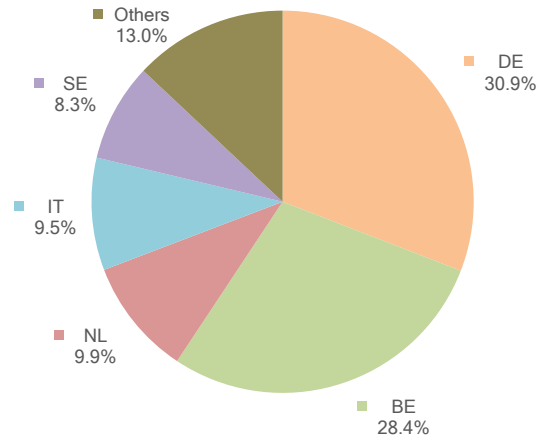
Note: Share of the top 5 EEA States and all others combined, out of the total number of internalised settlement instructions in the EEA as of 19Q4.
Sources: ESMA.



Note: Share of the top 5 EEA States and all others combined, out of the total number of internalised settlement instructions in the EEA as of 20Q1.
Sources: ESMA.



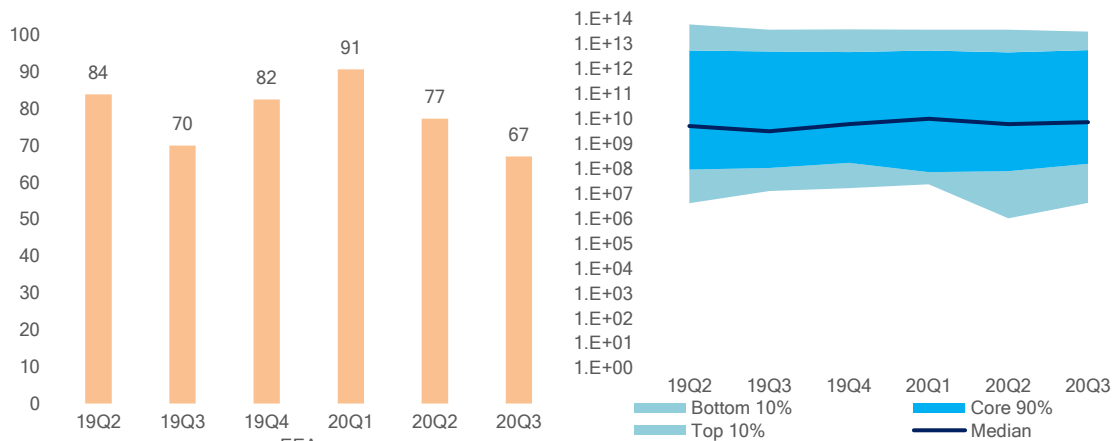
Note: Share of the top 5 EEA States and all others combined, out of the total number of internalised settlement instructions in the EEA as of 20Q2. Sources: ESMA.



Note: Share of the top 5 EEA States and all others combined, out of the total number of internalised settlement instructions in the EEA as of 20Q3. Sources: ESMA.

3. Value (EUR, trillions) of internalised settlement instructions per reporting quarter (EEA)

- ESMA notices a decrease in the value of internalised settlement at EEA level in Q3 2019 compared to Q2 2019, followed by an increase in the following two quarters, and then a decrease in Q2 2020.
- The total internalised settlement value per EEA State is very dispersed, ranging from a few million Euros in some cases to several tens of trillion Euros for the jurisdictions with more internalised settlement activity. However, it remains relatively stable over time as demonstrated by the evolution of the width and levels displayed in the dispersion chart below (i.e. Bottom 10%, Core 90%, Top 10% and Median).
- While ESMA acknowledges that not all settlement internalisers may have used this approach (given the ongoing data quality checks), it is expected that settlement internalisers have included the value of each separate internalised settlement instruction in the aggregate figures (i.e. double side reporting), and that they have reported the value of instructions by taking into account each business day until they are settled, according to the ESMA Guidelines on internalised settlement reporting. Please see Section 5.2 for more details.



Note: Total internalised settlement value per reporting quarter in the EEA, in EUR tn. Sources: ESMA.

Note: Dispersion of the total internalised settlement value per EEA State, in EUR, per reporting quarter. Displayed using a logarithmic scale. Sources: ESMA.

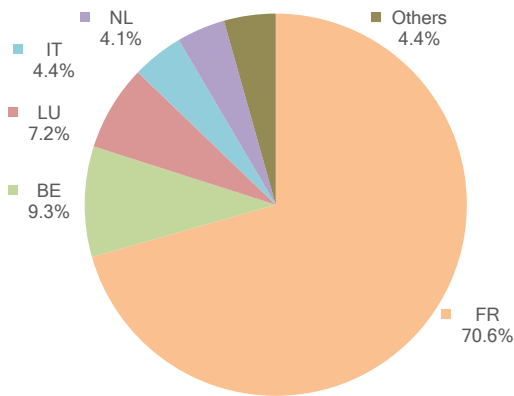
- The breakdown per EEA State in terms of the value (in EUR) of internalised settlement per quarter is included below.

EEA States ⁸	Total internalised settlement value (in EUR)					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
AT	56,506,996,694	32,750,412,777	65,993,835,587	90,866,322,170	152,792,772,277	129,358,781,945
BE	7,829,223,985,339	18,499,958,525,151	29,574,136,071,822	36,706,238,364,782	35,922,603,690,919	30,555,837,824,092
CY	310,572,925,872	250,533,015,389	282,674,275,103	269,356,243,728	25,706,915,135	236,544,708,432
CZ	2,343,226,826	3,092,095,571	12,691,336,140	9,783,072,270	8,676,220,088	1,847,821,666
DE	1,868,064,391,538	1,623,846,177,211	2,189,725,451,832	3,042,248,610,713	3,827,507,960,810	6,078,779,837,340
DK	4,180,725,852	5,943,523,584	11,175,348,306	7,945,933,857	5,962,873,451	5,120,289,879
EE	404,164,900	194,947,765	214,132,888	66,198,625	79,401,168	181,740,846
ES	13,397,196,617	14,807,888,610	4,583,726,261	10,069,124,141	3,117,777,417	4,629,592,788
FI	5,819,597,968	117,222,803	153,881,862	651,109,077	4,553,593,551	9,998,970,619
FR	59,157,347,142,424	36,716,033,215,680	37,661,376,948,923	35,636,564,764,481	22,462,144,576,129	16,912,174,091,723
HR	1,956,320,015	211,677,595	928,639,598	999,720,333	3,047,005,693	419,962,973
HU	3,160,712,399	3,080,015,853	3,325,143,770	2,537,354,221	2,195,389,631	2,024,676,757
IE	697,881,613,664	565,553,839,008	832,642,926,934	929,734,824,042	2,512,103,432,914	1,504,147,440,737
IT	3,648,973,194,968	2,477,036,274,020	1,907,291,797,621	2,458,733,373,273	2,321,783,643,343	1,286,641,108,636
LI				9,155,455,471	7,652,388,912	5,047,963,363
LT	913,745,597	435,561,280	357,550,961	236,014,172	679,608,609	126,353,545
LU	6,071,852,728,131	5,591,836,499,550	5,054,046,690,973	5,593,033,562,833	5,365,496,659,883	4,964,895,733,225
LV	91,248,707	928,659,645	1,047,994,323	23,467,573	74,327,431	33,136,314
MT	26,256,000	12,451,647	182,947,905	27,700,939	11,441,129	4,144,940
NL	3,432,404,317,242	3,700,004,977,839	4,131,473,966,438	5,166,500,563,217	3,959,687,983,588	4,719,241,395,202
NO			7,359,473,972	16,182,205,024	2,743,616,365	9,014,955,348
PL		203,591,450	282,116,989	111,904,022	175,229,067	204,849,806
PT	1,560,112,506	1,098,019,218	1,248,496,423	10,758,353,698	6,358,076,965	21,963,983,898
RO	469,512,638	815,889,309	1,195,364,859	888,145,360	585,640,849	381,812,279
SE	696,837,258,813	429,918,617,060	692,129,107,682	646,325,537,883	625,552,449,212	503,087,457,802
SI	4,113,314	20,863,620	16,492,426	74,732,852	1,004,855	
SK	91,006,589	95,136,711	109,614,796	110,472,854	127,271,087	285,021,992
Total EEA	83,804,082,494,613	69,918,529,098,346	82,436,363,334,394	90,609,223,131,611	77,221,420,950,478	66,951,993,656,147

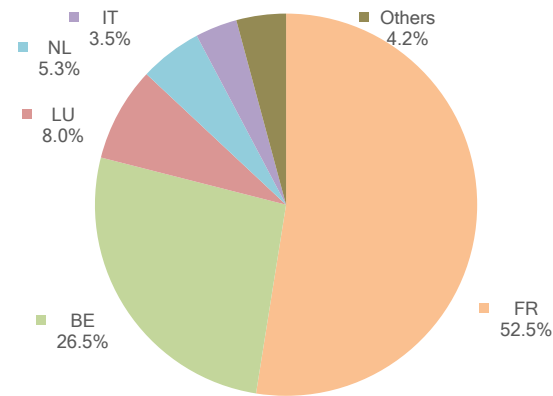
⁸ The NCAs from Bulgaria and Greece have not yet submitted internalised settlement reports from settlement internalisers in their jurisdiction to ESMA. The CSDR Level 2 Regulations have not yet been incorporated into Icelandic law and, therefore, the internalised settlement reporting requirements are not yet applicable in Iceland. UK data is not included, given the Brexit context.

4. Top 5 EEA States in the total internalised settlement value per reporting quarter

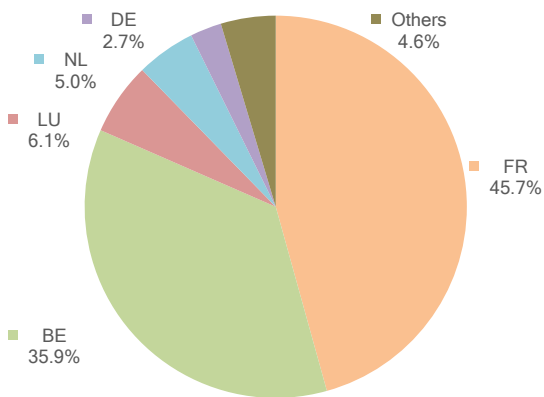
- It's important to bear in mind that Q2 and Q3 2019 figures may be more impacted than 2020 figures by data quality issues such as entities not reporting data or misreporting, given that data quality has improved with the more recent reports.
- It is also noted that a few settlement internalisers account for a significant part of the internalised settlement activity in particular jurisdictions, due to the high level of concentration.



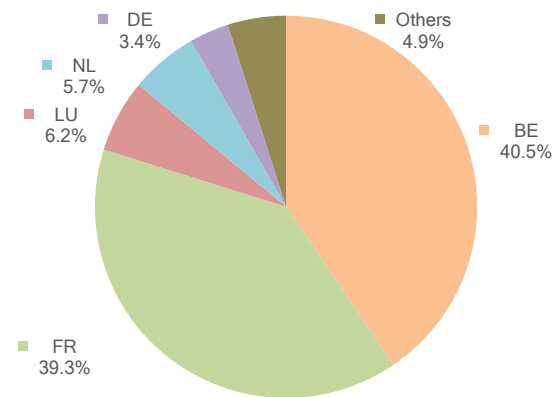
Note: Share of the top 5 EEA States and all others combined, out of the total internalised settlement value in the EEA as of 19Q2.
Sources: ESMA.



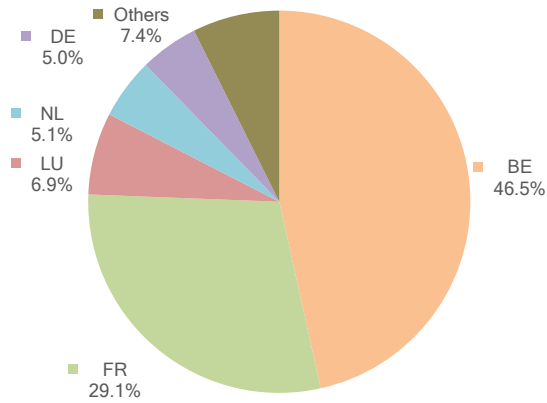
Note: Share of the top 5 EEA States and all others combined, out of the total internalised settlement value in the EEA as of 19Q3.
Sources: ESMA.



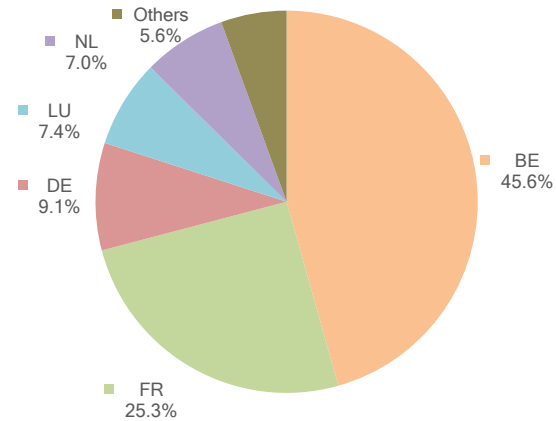
Note: Share of the top 5 EEA States and all others combined, out of the total internalised settlement value in the EEA as of 19Q4.
Sources: ESMA.



Note: Share of the top 5 EEA States and all others combined, out of the total internalised settlement value in the EEA as of 20Q1.
Sources: ESMA.



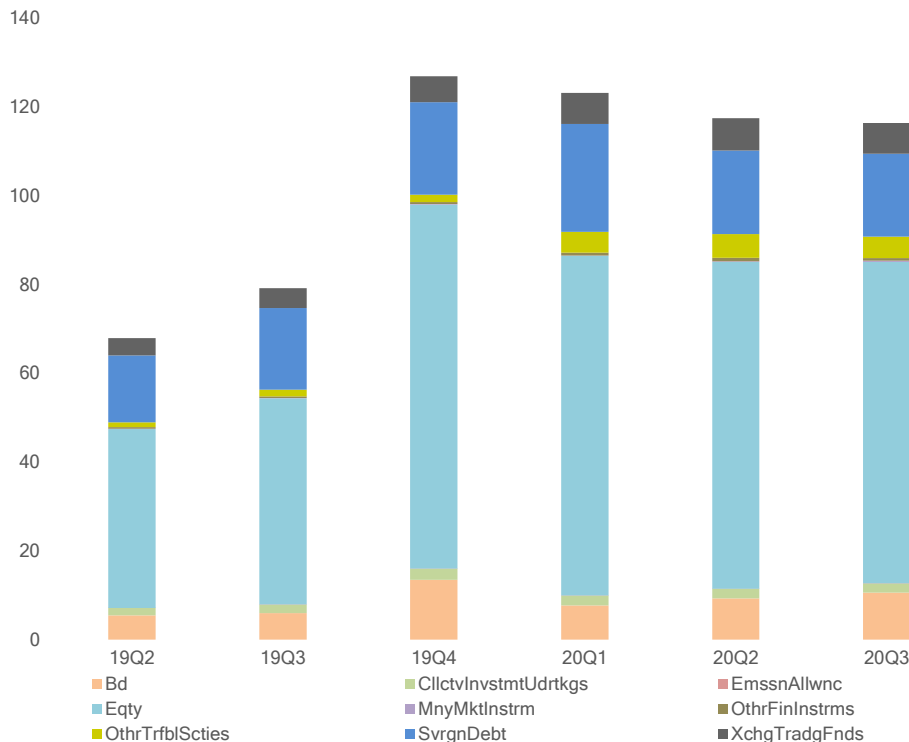
Note: Share of the top 5 EEA States and all others combined, out of the total internalised settlement value in the EEA as of 20Q2.
Sources: ESMA.



Note: Share of the top 5 EEA States and all others combined, out of the total internalised settlement value in the EEA as of 20Q3.
Sources: ESMA.

5. Number of internalised settlement instructions per type of financial instruments per reporting quarter (EEA)

- The majority of internalised settlement instructions (based on their number) concerns equities, followed in this order by: sovereign debt, bonds, ETFs, other transferable securities, UCITS (other than ETFs), other financial instruments, money market instruments, and emission allowances.

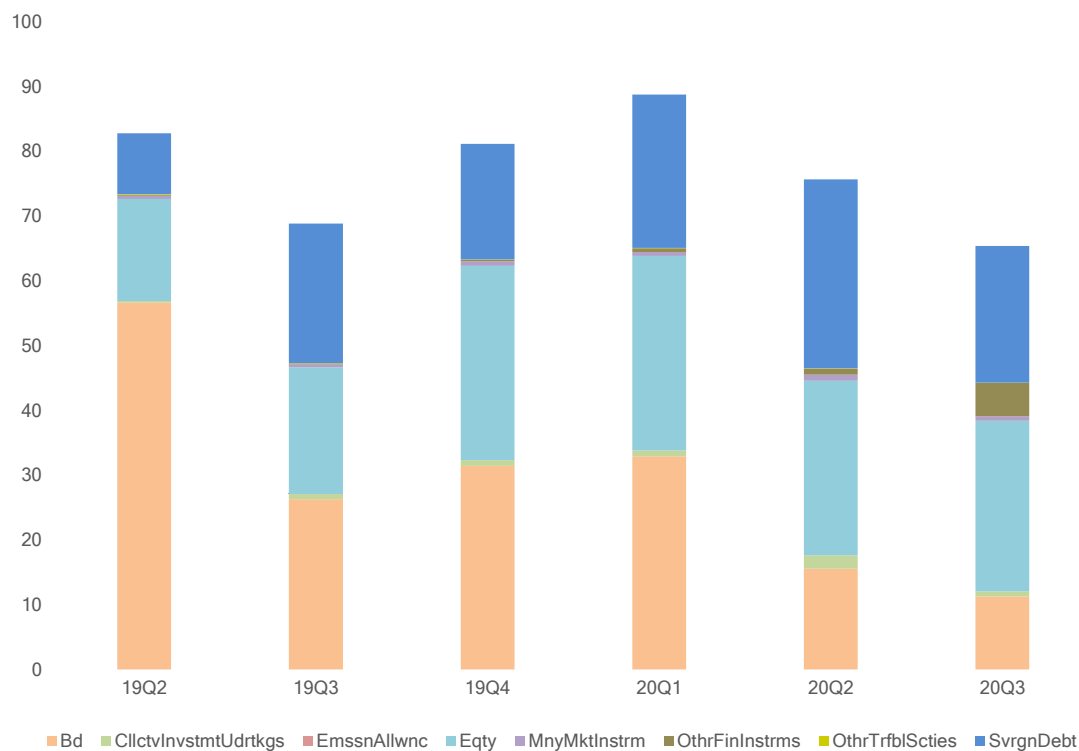


Note: Total number of internalised settlement instructions per type of financial instrument and per reporting quarter in the EEA, in millions.

Instrument type	Total number of internalised settlement instructions					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Equity (Eqty)	40,239,333	46,394,007	81,928,436	76,469,084	73,552,194	72,313,483
Sovereign debt (SvrgnDebt)	15,077,645	18,377,938	20,806,765	24,296,313	18,828,398	18,713,000
Bonds (Bd)	5,493,694	5,990,204	13,445,138	7,675,003	9,258,010	10,604,064
Other transferable securities (OthrTrfblScies)	1,089,181	1,493,542	1,660,473	4,705,762	5,290,996	4,819,448
ETFs (XchgTradgFnds)	3,858,627	4,452,913	5,837,497	6,939,514	7,284,731	6,864,708
UCITS, other than ETFs (ClctvInvstmtUdrtkgs)	1,652,656	1,932,023	2,527,129	2,235,181	2,195,660	2,088,225
Money market instruments (MnyMktInstrm)	95,969	109,990	140,134	121,368	177,336	329,564
Emission allowances (EmsnAllwnc)	46	86	106	138	605	138
Other financial instruments (OthrFinInstrms)	374,760	351,991	500,259	619,684	805,701	544,392
Total	67,881,911	79,102,694	126,845,937	123,062,047	117,393,631	116,277,022

6. Value of internalised settlement instructions per type of financial instruments per reporting quarter (EEA)

- The majority of internalised settlement instructions (based on their value in EUR) concerns equity, bonds and sovereign debt (in close proximity with the exception of Q2 2019 when bonds had a significantly higher proportion based on the reported data). By comparison, the following types of financial instruments have lower values reported: ETFs, money market instruments, UCITS (other than ETFs) and other financial instruments. Other transferable securities have even lower values, while emission allowances have the lowest proportion.

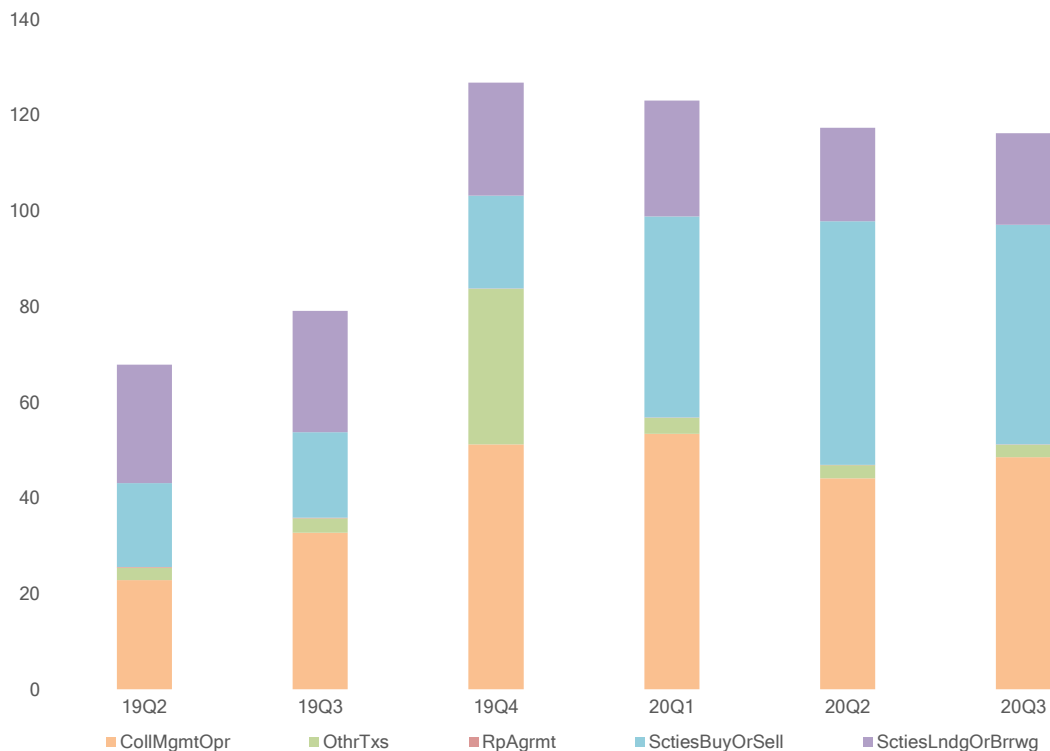


Note: Total internalised settlement value per type of financial instrument and per reporting quarter in the EEA, in EUR tn.
Sources: ESMA.

Instrument type	Total internalised settlement value (in EUR)					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Equity (Eqty)	15,768,090,288,933	19,524,163,234,666	30,026,932,141,462	30,084,279,106,225	26,951,726,953,879	26,311,620,341,341
Sovereign debt (SvrgnDebt)	9,426,660,585,245	21,525,473,076,464	17,833,570,540,350	23,675,291,509,447	29,147,228,941,065	21,106,505,914,037
Bonds (Bd)	56,621,427,058,934	26,268,849,780,084	31,426,217,592,166	32,922,702,322,251	15,565,660,361,649	11,266,226,915,676
Other transferable securities (OthrTrfblScties)	63,412,916,834	47,855,721,345	69,771,506,439	51,864,415,053	35,611,156,694	39,043,034,238
ETFs (XchgTradgFnds)	1,017,526,019,590	1,106,524,018,512	1,295,626,260,168	1,863,208,691,605	1,573,944,050,720	1,600,250,951,709
UCITS, other than ETFs (ClIctvInvstmtUdrtkgs)	241,770,219,064	827,383,467,143	864,297,825,286	846,657,836,087	2,064,811,931,416	801,134,503,467
Money market instruments (MnyMktInstrm)	494,264,877,903	469,091,608,373	661,717,447,695	589,874,811,896	903,098,440,759	680,271,190,085
Emission allowances (EmssnAllwnc)	81,843	15,438,306	473,336	921,623	1,385,125	582,920
Other financial instruments (OthrFinInstrms)	170,930,446,268	149,172,753,454	258,229,547,490	575,343,517,424	979,337,729,172	5,146,940,222,672
Total	83,804,082,494,614	69,918,529,098,347	82,436,363,334,392	90,609,223,131,611	77,221,420,950,479	66,951,993,656,145

7. Number of internalised settlement instructions per type of transaction per reporting quarter (EEA)

- Collateral management operations, together with securities purchases and sales and securities lending or borrowing operations represent the highest proportion based on the number of internalised settlement instructions. The category ‘other transactions’ has a smaller share in the total, with the exception of Q4 2019 when it was the second most reported category. Repurchase transactions consistently represent only a very small portion of the internalised settlement activity.



Note: Total number of internalised settlement instructions per type of transaction and per reporting quarter in the EEA, in millions.
Sources: ESMA.

Transaction type	Total number of internalised settlement instructions - EEA					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Securities purchase or sale (SctiesBuyOrSell)	17,546,864	17,879,104	19,375,533	42,008,868	50,874,555	45,903,536
Collateral management (CollMgmtOpr)	22,787,575	32,705,134	51,191,410	53,404,369	44,079,906	48,495,701
Securities lending or borrowing (SctiesLndgOrBrrwg)	24,774,155	25,381,984	23,665,988	24,201,760	19,580,290	19,173,076
Repurchase transactions (RpAgrmt)	98,058	98,005	103,288	125,884	110,560	78,774

Other transactions (OthrTxS)	2,675,259	3,038,467	32,509,718	3,321,166	2,748,320	2,625,935
Total	67,881,911	79,102,694	126,845,937	123,062,047	117,393,631	116,277,022

8. Value of internalised settlement instructions per type of transaction per reporting quarter (EEA)

- Collateral management operations represent the highest proportion based on the value of internalised settlement instructions, with the exception of Q2 2019 and Q3 2019, when they were surpassed by securities purchases and sales in both those quarters, and also by securities lending or borrowing operations in Q2 2019. Securities purchases and sales and securities lending or borrowing operations also represent an important part of the internalised settlement activity based on the number of instructions. Repurchase transactions and other transactions represent only a very small portion of the internalised settlement activity.



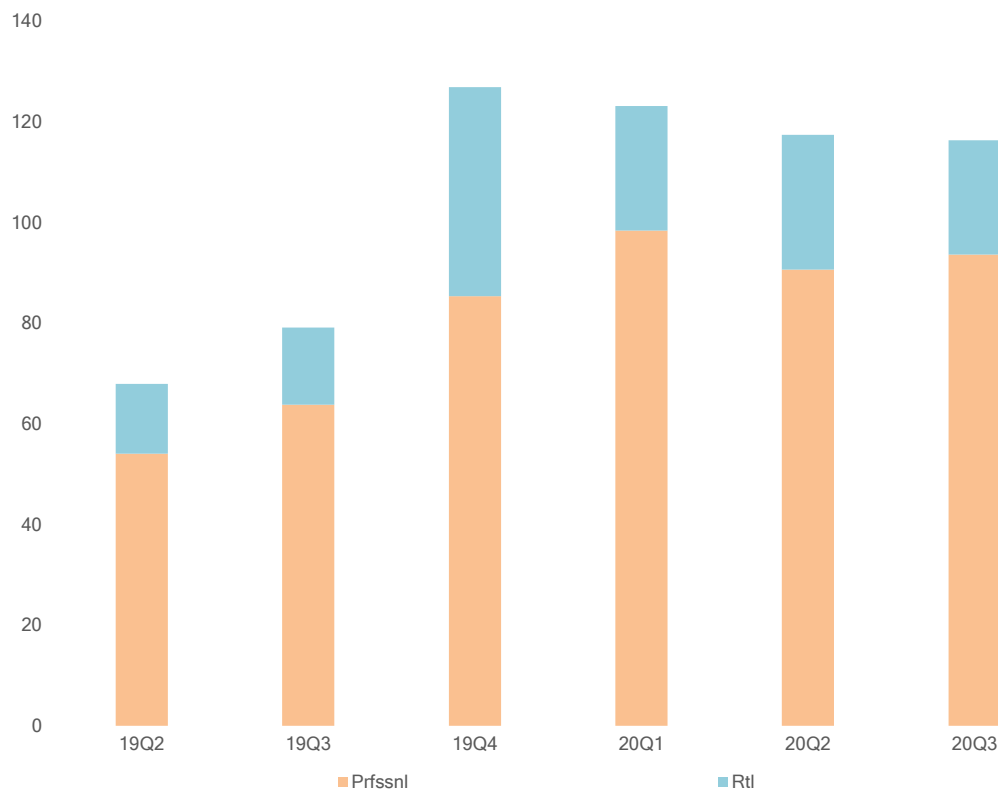
Note: Total internalised settlement value per type of transaction and per reporting quarter in the EEA, in EUR tn.
Sources: ESMA.

Transaction type	Total internalised settlement value (in EUR) – EEA					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Securities purchase or sale (SctiesBuyOrSell)	52,392,008,926,044	27,600,837,327,404	23,871,733,200,568	23,912,502,883,376	13,327,822,081,358	4,825,423,705,723
Collateral management (CollMgmtOpr)	13,665,203,444,915	23,665,018,907,748	34,803,856,115,822	42,621,749,306,254	41,741,944,566,966	36,092,074,205,152

Securities lending or borrowing (SctiesLndgOrBrrwg)	14,950,942,193,153	15,635,551,394,751	20,332,150,481,991	20,542,367,601,503	19,878,666,397,136	20,079,243,081,127
Repurchase transactions (RpAgrmt)	1,717,244,803,034	1,352,069,810,108	1,364,825,005,870	1,723,160,557,935	1,415,376,750,675	807,743,461,972
Other transactions (OthrTxS)	1,078,683,127,469	1,665,051,658,338	2,063,798,530,143	1,809,442,782,544	857,611,154,343	5,147,509,202,173
Total	83,804,082,494,615	69,918,529,098,349	82,436,363,334,394	90,609,223,131,612	77,221,420,950,478	66,951,993,656,147

9. Number of internalised settlement instructions per type of clients per reporting quarter (EEA)

- The majority of internalised settlement instructions (based on the number of instructions) concerns professional clients, even though the proportion of retail clients is higher in this case compared to the proportion based on the value of internalised settlement instructions.

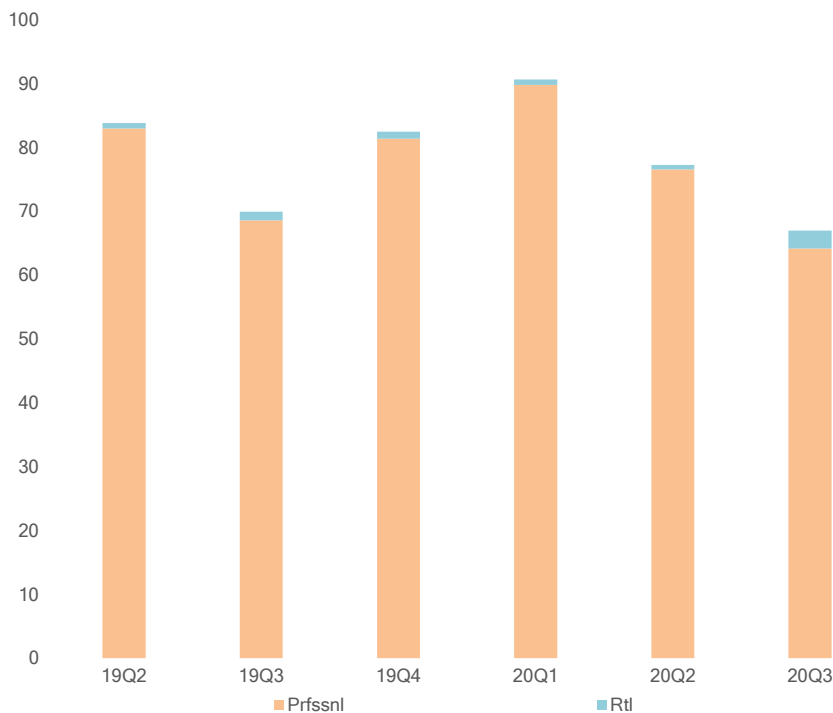


Note: Total number of internalised settlement instructions per type of client and per reporting quarter in the EEA, in millions.
Sources: ESMA.

Client type	Total number of internalised settlement instructions – EEA					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Professional clients (Prfssnl)	54,024,719	63,785,577	85,348,945	98,359,895	90,611,001	93,574,706
Retail clients (Rtl)	13,857,192	15,317,117	41,496,992	24,702,152	26,782,630	22,702,316
Total	67,881,911	79,102,694	126,845,937	123,062,047	117,393,631	116,277,022

10. Value of internalised settlement instructions per type of clients per reporting quarter (EEA)

- The vast majority of internalised settlement instructions (based on value) concerns professional clients.

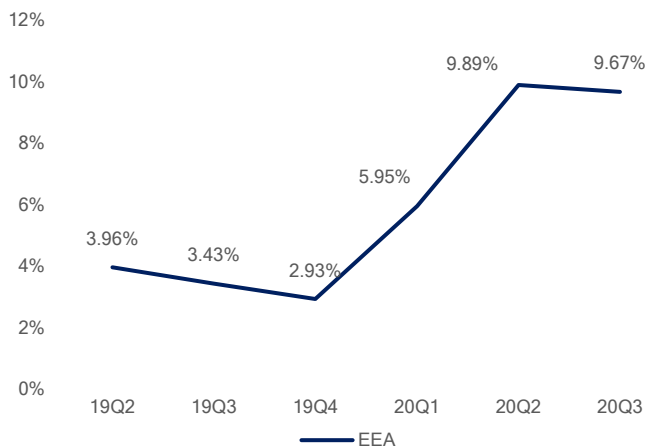


Note: Total internalised settlement value per type of client and per reporting quarter in the EEA, in EUR tn.
Sources: ESMA.

Client type	Total internalised settlement value (in EUR) – EEA					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Professional clients (Prfssnl)	82,965,851,627,778	68,568,547,379,334	81,330,666,401,382	89,748,772,069,178	76,541,259,933,282	64,134,874,477,163
Retail clients (Rtl)	838,230,866,834	1,349,981,719,015	1,105,696,933,011	860,451,062,433	680,161,017,196	2,817,119,178,983
Total	83,804,082,494,612	69,918,529,098,349	82,436,363,334,393	90,609,223,131,611	77,221,420,950,478	66,951,993,656,146

11. Internalised settlement fails rates (by number of instructions) per reporting quarter (EEA)

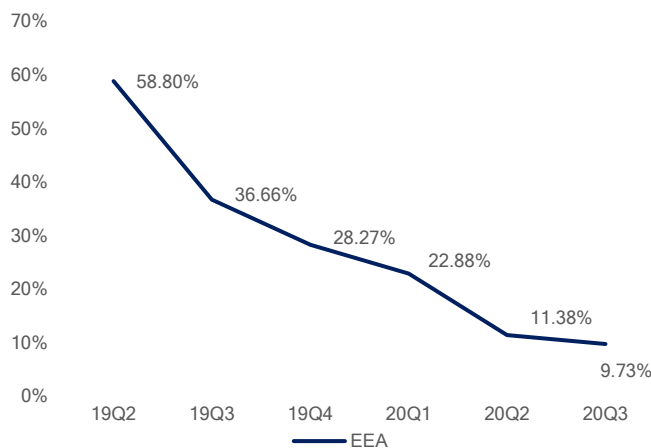
- ESMA notices an increase in the internalised settlement fail rates at EEA level, based on the number of internalised settlement instructions. This could also be due to the fact that initially some settlement internalisers misinterpreted the ‘volume’ of internalised settlement as referring to ‘number of securities’ rather than ‘number of instructions’. Following data quality checks, this has been corrected for the more recent reports.



Note: Fail rate by number of internalised settlement instructions per reporting quarter in the EEA, in %.
Sources: ESMA.

12. Internalised settlement fail rates (by value in EUR) per reporting quarter (EEA)

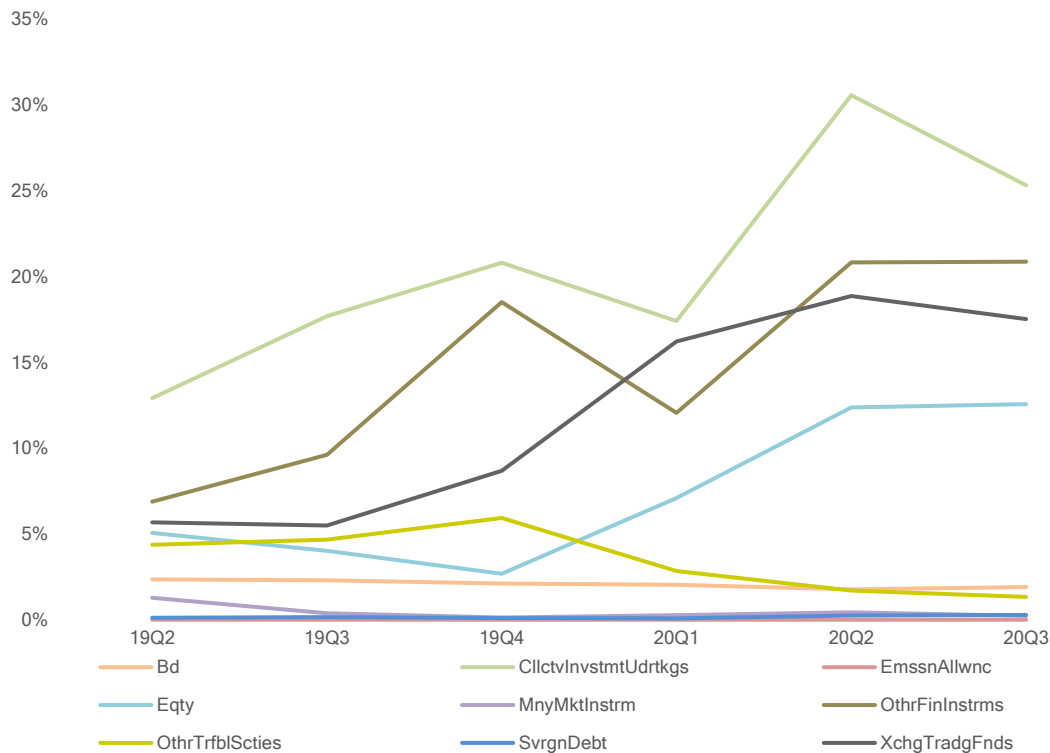
- We can notice a steady decrease trend in the internalised settlement fails rates at EEA level, based on the value of internalised settlement instructions.



Note: Fail rate by internalised settlement value per reporting quarter in the EEA, in %.
Sources: ESMA.

13. Internalised settlement fail rates (by number of instructions) per type of financial instruments per reporting quarter (EEA)

- ESMA notices an increasing trend in the level of internalised settlement fails (based on the number of instructions) for UCITS and ETFs, with very high rates.
- A similar trend can be noticed regarding the level of internalised settlement fails (based on the number of instructions) for equities and other financial instruments.



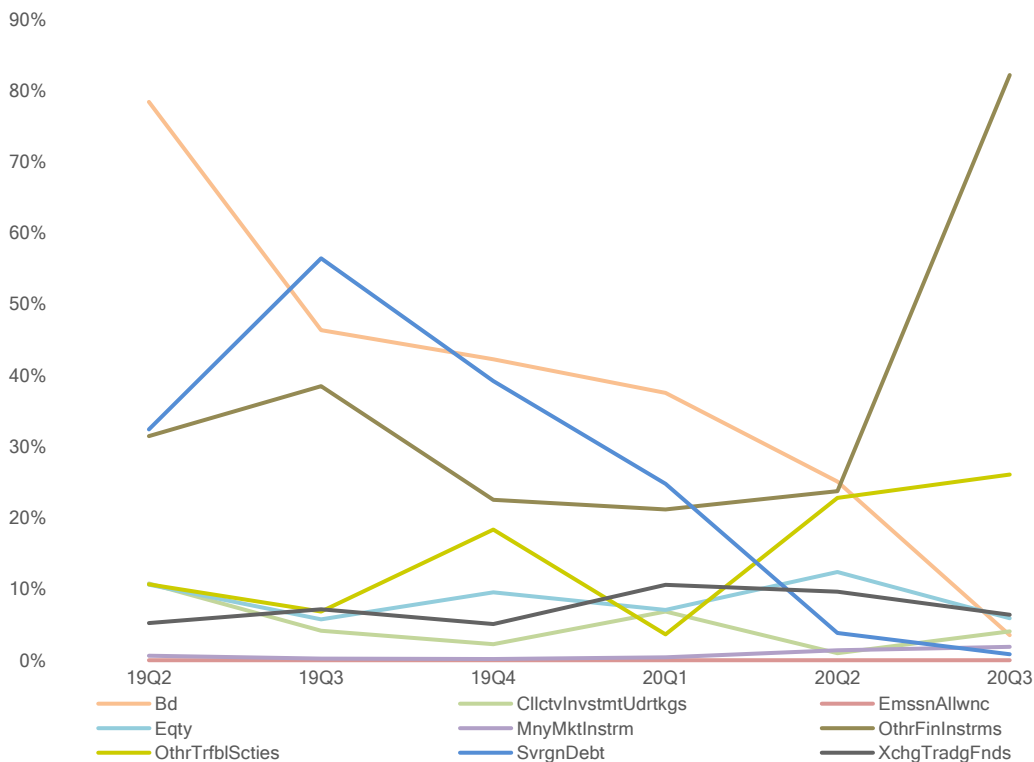
Note: Fail rate by number of internalised settlement instructions per EEA State, per type of financial instrument and per reporting quarter.
Sources: ESMA.

Instrument type	Internalised settlement fail rates (by number of instructions)					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Equity (Eqty)	5.06%	4.01%	2.68%	7.09%	12.37%	12.56%
Sovereign debt (SvrgrnDebt)	0.12%	0.15%	0.10%	0.08%	0.25%	0.28%
Bonds (Bd)	2.35%	2.30%	2.11%	2.03%	1.77%	1.90%
Other transferable securities (OthrTrfblScities)	4.37%	4.67%	5.93%	2.84%	1.71%	1.33%
ETFs (XchgTradgFnds)	5.68%	5.49%	8.68%	16.22%	18.86%	17.51%
UCITS, other than ETFs (CllctvInvstmtUdrtkgs)	12.91%	17.69%	20.80%	17.40%	30.56%	25.32%

Money market instruments (MnyMktInstrm)	1.28%	0.38%	0.13%	0.27%	0.43%	0.23%
Emission allowances (EmssnAllwnc)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Other financial instruments (OthrFinInstrms)	6.88%	9.60%	18.50%	12.06%	20.82%	20.86%

14. Internalised settlement fail rates (by value in EUR) per type of financial instruments per reporting quarter (EEA)

- ESMA notices an increasing trend in the level of internalised settlement fails (by value) for the category ‘other financial instruments’, with very high rates.
- ESMA also notices a decreasing trend in the level of internalised settlement fails (by value) for sovereign debt and bonds, starting from very high levels.
- High levels of internalised settlement fails (by value) can also be noticed for equities, ETFs and UCITS.

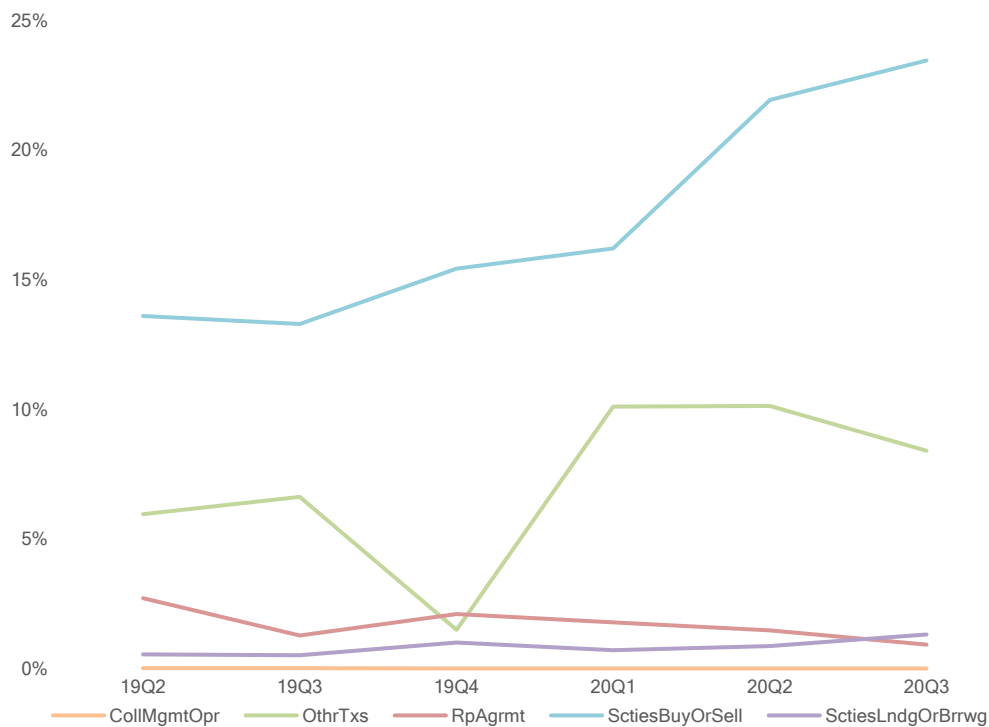


Note: Fail rate by internalised settlement value per EEA State, per type of financial instrument and per reporting quarter.
Sources: ESMA.

Instrument type	Internalised settlement fail rates (by value of instructions in EUR)					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Equity (Eqty)	10.62%	5.74%	9.55%	7.08%	12.39%	5.91%
Sovereign debt (SvrgnDebt)	32.43%	56.45%	39.22%	24.78%	3.82%	0.84%
Bonds (Bd)	78.42%	46.38%	42.27%	37.53%	25.10%	3.52%
Other transferable securities (OthrTrfblScties)	10.67%	6.84%	18.36%	3.63%	22.79%	26.08%
ETFs (XchgTradgFnds)	5.20%	7.14%	5.08%	10.59%	9.64%	6.39%
UCITS, other than ETFs (ClctvInvstmtUdrtkgs)	10.78%	4.16%	2.24%	6.83%	0.99%	4.05%
Money market instruments (MnyMktInstrm)	0.65%	0.25%	0.17%	0.40%	1.38%	1.88%
Emission allowances (EmssnAllwnc)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Other financial instruments (OthrFinInstrms)	31.48%	38.49%	22.55%	21.18%	23.73%	82.19%

15. Internalised settlement fail rates (number of instructions) per type of transaction per reporting quarter (EEA)

- ESMA notices an increasing trend in the level of internalised settlement fails for securities purchases or sales (based on the number of instructions), with high rates overall.

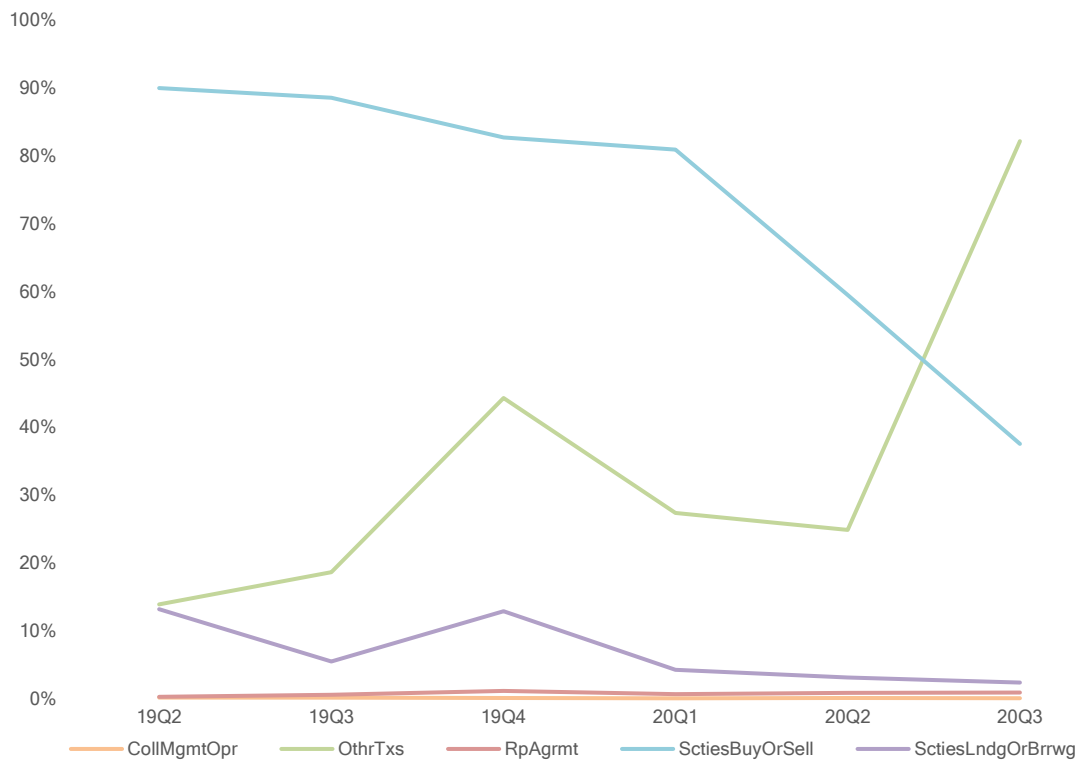


Note: Fail rate by number of internalised settlement instructions per EEA State, per type of transaction and per reporting quarter. Sources: ESMA.

Transaction type	Internalised settlement fail rates (by number of instructions)					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Securities purchase or sale (SctiesBuyOrSell)	13.60%	13.29%	15.43%	16.20%	21.93%	23.45%
Collateral management (CollMgmtOpr)	0.02%	0.02%	0.01%	0.01%	0.01%	0.01%
Securities lending or borrowing (SctiesLndgOrBrrwg)	0.55%	0.52%	1.01%	0.71%	0.88%	1.32%
Repurchase transactions (RpAgrmt)	2.72%	1.28%	2.11%	1.79%	1.48%	0.93%
Other transactions (OthrTxS)	5.96%	6.62%	1.50%	10.11%	10.13%	8.40%

16. Internalised settlement fail rates (by value in EUR) per type of transaction per reporting quarter (EEA)

- ESMA notices extremely high internalised settlement fails rates for securities purchases or sales, based on the value of transactions. However, it appears that they are on a decreasing trend.
- The level of internalised settlement fails rates for the category 'other transactions' based on the value of transactions appears to be on an increasing trend.

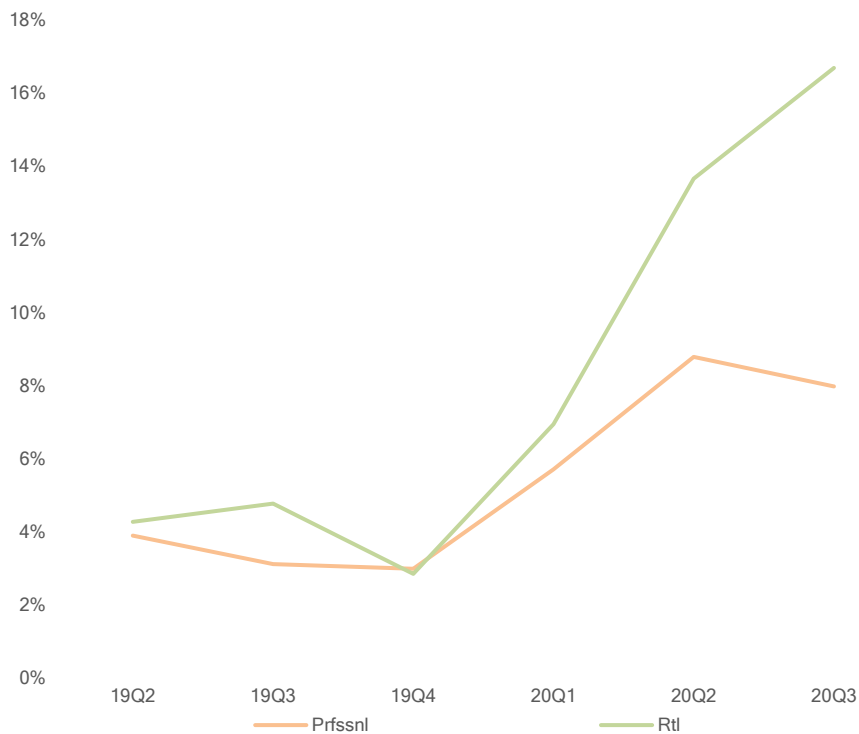


Note: Fail rate by internalised settlement value per EEA State, per type of financial instrument and per reporting quarter.
Sources: ESMA.

Transaction Type	Internalised settlement fail rates (by value of instructions in EUR)				
	2019			2020	
	19Q2	19Q3	19Q4	20Q1	20Q2
Securities purchase or sale (ScitiesBuyOrSell)	89.99%	88.46%	82.70%	80.94%	59.47%
Collateral management (CollMgmtOpr)	0.11%	0.07%	0.04%	0.02%	0.05%
Securities lending or borrowing (ScitiesLndgOrBrrwg)	13.14%	2.98%	12.86%	4.21%	3.09%
Repurchase transactions (RpAgrmt)	0.22%	0.52%	1.09%	0.60%	0.80%
Other transactions (OthrTxS)	13.86%	10.05%	44.36%	27.36%	24.85%
Total	58.80%	41.57%	28.27%	22.88%	11.38%

17. Internalised settlement fail rates (by number of instructions) per type of clients per reporting quarter (EEA)

- ESMA notices an increasing trend in the internalised settlement fails rates (based on the number of instructions) both for retail and professional clients, with slightly higher fail rates for retail clients.

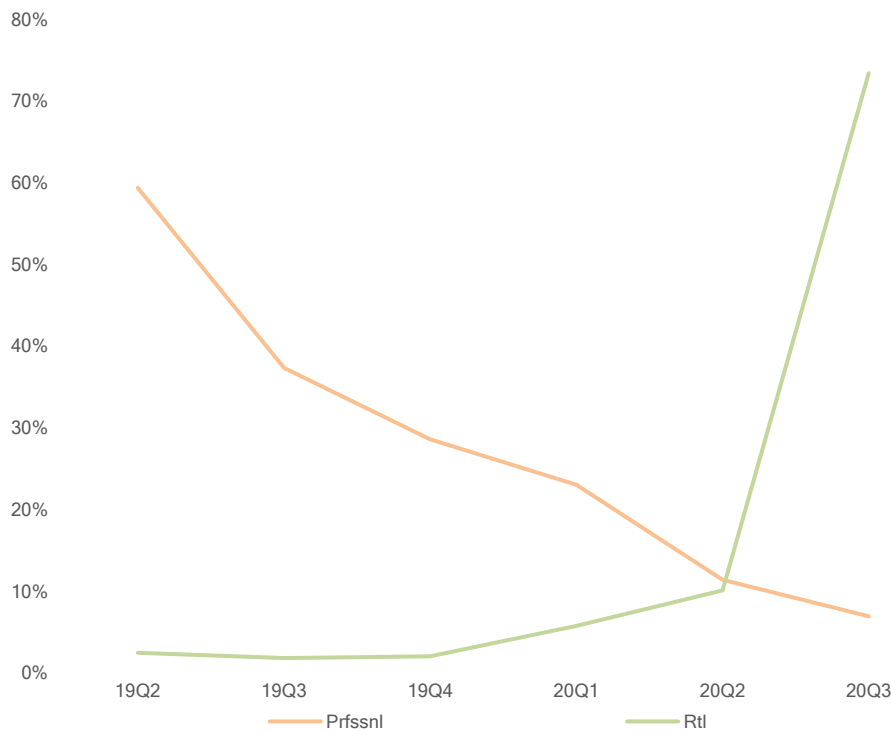


Note: Fail rate by number of internalised settlement instructions per EEA State, per type of client and per reporting quarter. Sources: ESMA.

Client type	Internalised settlement fail rates (by number of instructions)					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Professional clients (Prfssnl)	3.89%	3.11%	2.98%	5.70%	8.78%	7.97%
Retail clients (Rtl)	4.26%	4.76%	2.84%	6.94%	13.66%	16.69%

18. Internalised settlement fail rates (by value in EUR) per type of clients per reporting quarter (EEA)

- On the one hand, ESMA notices a decreasing trend in the internalised settlement fail rates (based on the value of instructions in EUR) for professional clients.
- On the other hand, ESMA notices an increasing trend in the internalised settlement fail rates (based on the value of instructions in EUR) for retail clients, with a particularly high rate in Q3 2020.

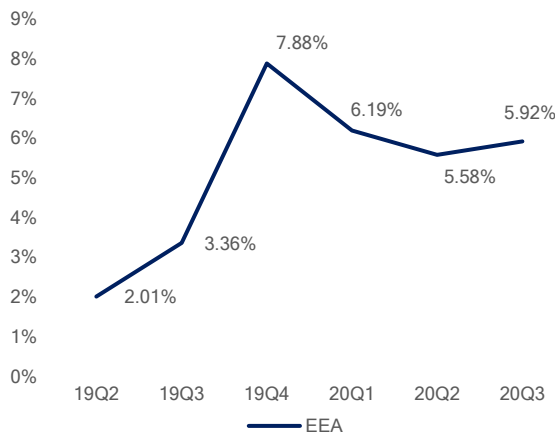


Note: Fail rate by internalised settlement value per EEA State, per type of client and per reporting quarter.
Sources: ESMA.

Instrument type	Total settlement value (in EUR)					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
Professional clients (Prfssnl)	59.37%	37.34%	28.62%	23.05%	11.39%	6.94%
Retail clients (Rtl)	2.46%	1.83%	2.06%	5.77%	10.10%	73.40%

19. Normalised Herfindahl-Hirschman index by number of internalised settlement instructions, per reporting quarter in the EEA, in %.

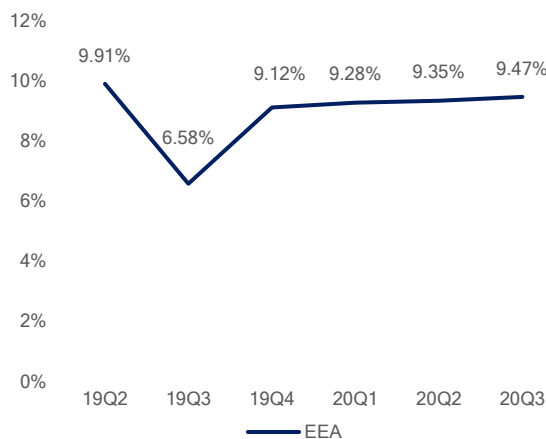
- ESMA notices an increasing trend in the level of concentration of the internalised settlement activity at EEA level, based on the number of internalised settlement instructions.



Note: Normalised Herfindahl-Hirschman index by number of internalised settlement instructions per reporting quarter in the EEA, in %.
Sources: ESMA.

20. Normalised Herfindahl-Hirschman index by internalised settlement value, per reporting quarter in the EEA, in %.

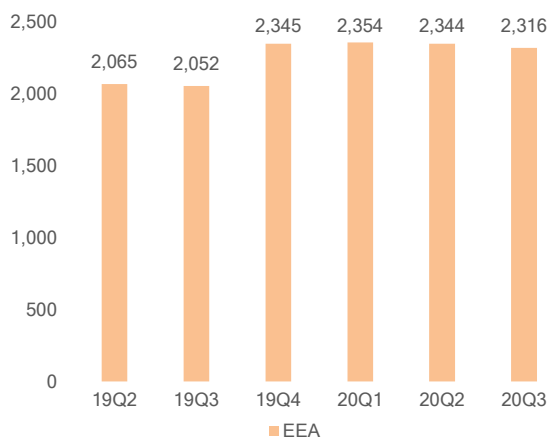
- ESMA notices that the level of concentration of the internalised settlement activity at EEA level based on the internalised settlement value is fairly constant.



Note: Normalised Herfindahl-Hirschman index by internalised settlement value per reporting quarter in the EEA, in %.
Sources: ESMA.

21. Number of settlement internalisers, per reporting quarter in the EEA

- ESMA notices an increase in the number of settlement internalisers submitting reports under Article 9 of CSDR. ESMA believes that the Q2 2020 figures are more accurate than the 2019 figures due to the learning effect and progressive onboarding of settlement internalisers late in the implementation. It's important to bear in mind that Q2 and Q3 2019 figures may be more impacted than 2020 figures by data quality issues such as entities not reporting data or misreporting, given that data quality has improved with the more recent reports. It should also be mentioned that some settlement internalisers may not have submitted the reports for Q3 2020 at the time the data for this Report was compiled.



Note: Total number of settlement internalisers per reporting quarter in the EEA.
Sources: ESMA.

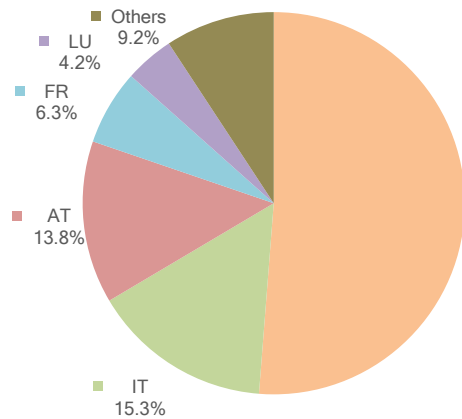
EEA States ⁹	Number of settlement internalisers ¹⁰					
	2019			2020		
	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3
NCA						
AT	284	268	302	305	278	316
BE	14	13	13	13	13	11
CY	19	20	20	20	17	11
CZ	15	15	14	14	14	9
DE	1,058	1,024	1,252	1,246	1,246	1,228
DK	26	25	24	26	26	30
EE	5	5	5	5	5	5
ES	11	12	13	12	12	10
FI	5	5	5	1	6	6
FR	131	132	133	133	133	129

⁹ The NCAs from Bulgaria and Greece have not yet submitted internalised settlement reports from settlement internalisers in their jurisdiction to ESMA. The CSDR Level 2 Regulations have not yet been incorporated into Icelandic law and, therefore, the internalised settlement reporting requirements are not yet applicable in Iceland. UK data is not included, given the Brexit context.

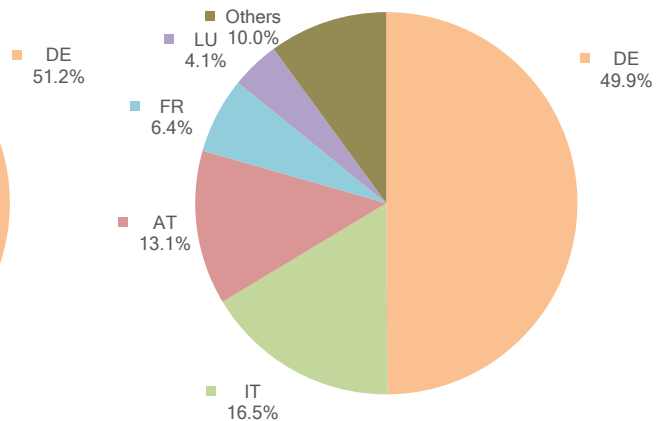
¹⁰ The cut-off date for the data included in this Report is **20 October 2020**. It should be mentioned that, by 23 October 2020, ESMA received additional reports for Q3 2020 from: 2 SetIns from BE, 6 SetIns from CY, 2 SetIns from the CZ, 2 SetIns from DE, 2 SetIns from FR, 2 SetIns from HR, 4 SetIns from IT, 4 SetIns from LU, 1 SetIn from PL, and 1 SetIn from PT.

HR	15	15	15	15	15	13
HU	2	3	4	5	5	3
IE	7	7	7	7	7	7
IT	315	338	365	361	361	354
LI				7	8	8
LT	4	4	4	4	4	3
LU	86	84	82	82	82	71
LV	9	10	11	9	10	8
MT	3	4	5	8	10	6
NL	14	15	15	15	15	15
NO			1	1	1	1
PL		12	11	11	11	11
PT	12	13	13	14	14	12
RO	4	4	4	4	4	4
SE	8	8	7	15	14	13
SI	8	8	8	8	2	
SK	10	8	12	13	31	32
Total EEA	2,065	2,052	2,345	2,354	2,344	2,316

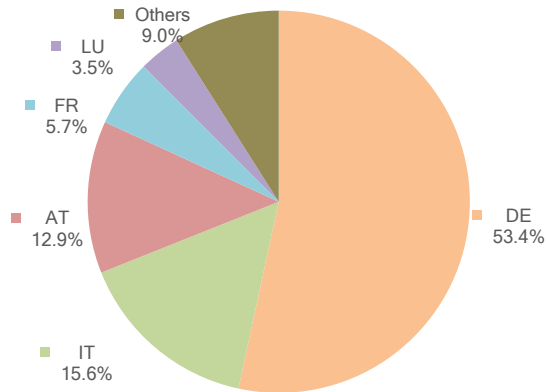
22. Top 5 EEA States based on the number of settlement internalisers, per reporting quarter



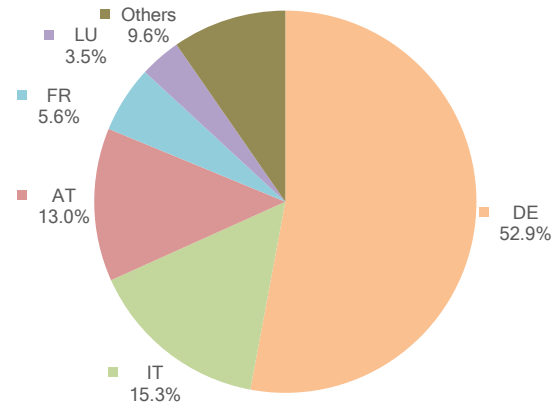
Note: Share of the top 5 EEA States and all others combined, out of the total number of settlement internalisers in the EEA as of 19Q2.
Sources: ESMA.



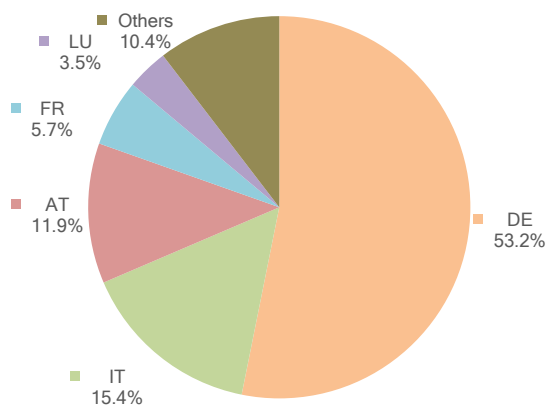
Note: Share of the top 5 EEA States and all others combined, out of the total number of settlement internalisers in the EEA as of 19Q3.
Sources: ESMA.



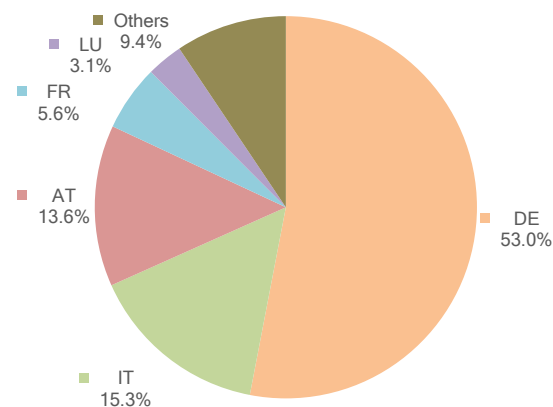
Note: Share of the top 5 EEA States and all others combined, out of the total number of settlement internalisers in the EEA as of 19Q4. Sources: ESMA.



Note: Share of the top 5 EEA States and all others combined, out of the total number of settlement internalisers in the EEA as of 20Q1. Sources: ESMA.



Note: Share of the top 5 EEA States and all others combined, out of the total number of settlement internalisers in the EEA as of 20Q2. Sources: ESMA.



Note: Share of the top 5 EEA States and all others combined, out of the total number of settlement internalisers in the EEA as of 20Q3. Sources: ESMA.

5.2 Data quality checks

75. ESMA would like to highlight that data quality checks are ongoing, and that there are still issues that need to be addressed by settlement internalisers. ESMA is coordinating with NCAs in order to follow up on the identified data quality issues.

76. The data presented in this Report excludes outliers. The rules applied to exclude outliers are the following (unless the accuracy of the data has been confirmed by the respective NCAs):

- if > 100,000,000 for the total number of internalised settlement instructions reported by a settlement internaliser for a quarter; or
- if > 100,000,000,000,000 EUR for the internalised settlement value reported by a settlement internaliser for a quarter; or
- an overall average internalised settlement value < 100 EUR or > 300,000,000 EUR reported by a settlement internaliser for a quarter.

77. The most common sources of errors identified so far are:

- a) Errors due to currency conversion;
- b) Errors due to volumes being misinterpreted as number of securities instead of number of instructions;
- c) Errors due to free of payment (FoP) instructions not being valued correctly (please see the provisions of Article 2(3) of the Commission Delegated Regulation (EU) 2017/391);
- d) Errors due to not counting instructions for the number of days until they are settled (in the total of instructions), while counting settlement fails for the number of days until they are settled, leading to disproportionate fail rates.
- e) Errors due to inverting figures related to failed instructions and figures related to settled instructions, leading to disproportionate fail rates.

78. Please see the relevant provisions of the ESMA Guidelines on internalised settlement reporting, which clarify some of the aspects mentioned above:

20. Settlement internalisers should include each separate internalised settlement instruction in the aggregate figures (i.e. double side reporting).

21. Volumes should be expressed in the number of internalised settlement instructions.

22. If during a quarter covered by a report, an internalised settlement instruction fails to settle for several days after the intended settlement date (ISD), including in the case where the settlement instruction is cancelled, then it should be reported as “failed” by taking into account each day when it fails to settle. It should be reported as “settled” if it is settled during the quarter covered by the report.

Please see the following example: If during the quarter covered by the report an internalised settlement instruction with a value of 100 euros fails to settle for 3 days, and then it is settled, it should be reported as follows (considering double side reporting):

Settled		Failed		Total	
Volume	Value (EUR)	Volume	Value (EUR)	Volume	Value (EUR)
2	200	6	600	8	800

6. Conclusions

79. In terms of the typology, settlement internalisers are usually credit institutions and investment firms. No major risks have been identified during the period covered by the report. NCAs have however identified some risks related to this activity, the most common being operational risk and custody risk. In terms of measures to mitigate those risks, ESMA would like to refer to the adequate identification of the clients’ accounts involved, and the improvement of the operational processes.

80. The challenges encountered when implementing the internalised settlement reporting regime seem normal in terms of any new reporting requirements. To support the implementation process, ESMA has provided additional clarifications through supervisory

convergence measures, including the ESMA Guidelines on internalised settlement reporting, as well as Q&As.

81. Given that this is a new reporting regime, and that data quality checks are still ongoing, it is acknowledged that data covering a longer period of time would be needed in order to have a clearer picture regarding internalised settlement trends. At the same time, it is useful to use the existing data to set a benchmark for future assessments.
82. ESMA would like to highlight the importance of continuing to monitor internalised settlement, in order to assess if this activity should be regulated in the future, in particular considering the extremely high values and volumes of internalised settlement according to the reports submitted by settlement internalisers under Article 9 of CSDR, as well as the high level of concentration with some settlement internalisers accounting for a significant part of the internalised settlement activity. ESMA believes that, as a minimum, custodians' clients should be informed of the risks and costs associated with the place of settlement (at the level of a securities settlement system operated by a CSD versus internalised settlement).

7. Annexes

7.1 Annex I – ESMA survey on internalised settlement (ref. ESMA70-156-3003/ 11 June 2020)

General information

1. Choose your jurisdiction:	[list of countries]
2. Please, provide the name of your institution/ organisation and your capacity: NCA ¹¹ / Trade Association	[blank space]
3. If applicable, please indicate: - for NCAs, the name of other authorities which have contributed to your answers (e.g. authorities supervising the settlement internalisers ¹²) - for AFME and EBF, the names of the market participants which have contributed to your answers	[blank space]
4. Please, provide the contact details of the person answering this questionnaire (Name, position and email address)	[blank space]
5. If applicable, please, provide the name of the CSD(s) for which you are NCA	[blank space]

Survey

1. Have you identified any risks in relation to internalised settlement?
 - a) Yes
 - b) No

[Q dependent on 1(a)] If yes, please list the identified risks:

Risks	Impact [very low, low, medium, high, very high]	Probability to materialise [very low, low, medium, high, very high]	Measures to prevent/address the materialisation of such risks	Other comments

¹¹ The competent authority designated under Article 11(1) of CSDR in each Member State.

¹² The CSD NCA is encouraged to liaise with the authorities supervising settlement internalisers (e.g. banking supervisors), if they are different than the CSD NCA. The CSD NCA may also liaise with the authorities in other Member States supervising settlement internalisers that have branches operating in the CSD NCA's Member State.

Operational risk				
Systemic risk				
Custody risk				
Counterparty risk				
Credit risk				
Liquidity risk				
Legal risk				
Others (please specify) ¹³				

2. Have you identified any trends in relation to internalised settlement?

- a) Yes
- b) No

[Q dependent on 2(a)] If yes, please provide details: *[insert text box]*

3. Please indicate the type of institutions which qualify as settlement internalisers:

Type of institutions	Indicate number of settlement internalisers falling under each type of institution	Comments
Investment firms		
Credit institutions		
Others (please specify)		

4. Please indicate the requirements, whether procedural or substantive, which were the most challenging to implement. *[insert text box]*

5. Do you consider the internalised settlement reporting process and/or the sharing of data amongst NCAs could be improved?

- a) Yes
- b) No
- c) No opinion

¹³ Possibility to add more rows if needed.

[Q dependent on Q5(a)] If yes, please indicate your suggestions for improving the process: *[insert text box]*

[Q dependent on Q5(a)] If yes, please provide suggestions for potential amendments to the existing requirements on internalised settlement reporting.

Regulation	Suggested amendments ¹⁴	Justification including evidence and data
Regulation (EU) No 909/2014 (CSDR) ¹⁵		
Commission Delegated Regulation (EU) 2017/391 ¹⁶		
Commission Implementing Regulation (EU) 2017/393 ¹⁷		

6. Please rate (from 1-5) the likelihood of settlement moving away from CSDs to settlement internalisers following the entry into force of the CSDR settlement discipline regime:

- 1 – very low
- 2 – low
- 3 – medium
- 4 – high
- 5 – very high
- No opinion

7. In your view, should internalised settlement be regulated?

- a) Yes
- b) No
- c) No opinion

[Q dependent on Q7(a)] If yes, please indicate your suggestions:

Areas linked to the internalised activity that would need to be regulated ¹⁸	Justification	If relevant, concrete proposals

¹⁴ Possibility to add separate rows for each suggested amendment and related justification.

¹⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014R0909>

¹⁶ https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2017.065.01.0044.01.ENG&toc=OJ:L:2017:065:TOC

¹⁷ https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2017.065.01.0116.01.ENG&toc=OJ:L:2017:065:TOC

¹⁸ Possibility to add separate rows for each suggestion.

7.3 Annex II – List of respondents to the ESMA survey on internalised settlement and contributors to this Report

NCA's

1. AT Austrian Financial Market Authority (FMA)
2. BE National Bank of Belgium
3. CZ Czech National Bank
4. DE Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin, Federal Financial Supervisory Authority)
5. DK Finanstilsynet
6. ES Comisión Nacional del Mercado de Valores (CNMV)
7. FI Financial Supervisory Authority (FIN-FSA)
8. FR Autorité des Marchés Financiers (AMF)
9. HR Croatian Financial Services Supervisory Agency
10. HU National Bank of Hungary (Magyar Nemzeti Bank)
11. IE Central Bank of Ireland
12. IS The Central Bank of Iceland
13. IT Commissione Nazionale per le Società e la Borsa (CONSOB)
14. LI FMA Liechtenstein
15. LT Lietuvos bankas
16. LU Commission de Surveillance du Secteur Financier (CSSF)
17. LV Financial and Capital Market Commission
18. MT Malta Financial Services Authority
19. NL De Nederlandsche Bank (DNB, Netherlands Bank)
20. NO Finanstilsynet (The Financial Supervisory Authority of Norway)
21. PL Polish Financial Supervision Authority (KNF)
22. PT Comissão do Mercado de Valores Mobiliários
23. RO Autoritatea de Supraveghere Financiară
24. SE Finansinspektionen
25. SI Securities Market Agency (ATVP)
26. SK National Bank of Slovakia

Trade Associations

1. Association for Financial Markets in Europe (AFME)
2. European Banking Federation (EBF)