

# Central Securities Depository Regulation

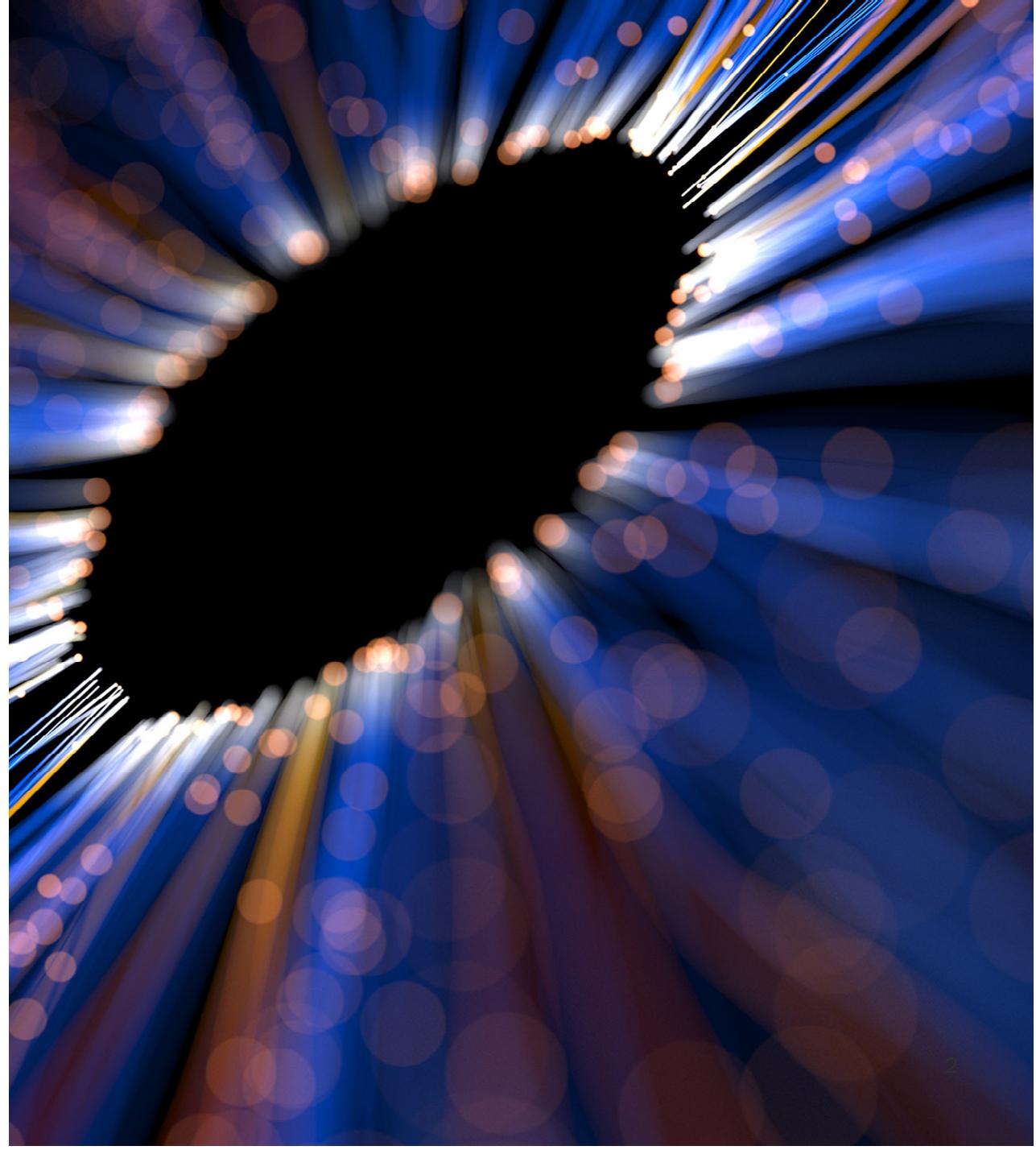
## Settlement Discipline Rules

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# Agenda

- 1 What is CSDR?
- 2 Settlement Discipline Rules
  - Prevention
  - Monitoring & reporting
  - Cash penalties
  - Mandatory buy-in
- 3 Future developments



# Central Securities Depositories Regulation – What is it?

- CSDR entered into force on 17 September 2014. Some key provisions are yet to apply
- The CSDR replaces national regimes and introduces an EU-wide harmonised framework for:
  - The **timing and method of securities settlement**: aligns settlement periods
  - The **authorisation**, supervision and operational arrangements for central securities depositories (**CSDs**) to facilitate settlement of cross-border transactions
  - **Common access rules** so as to create a **single market for CSDs and settlement services**

A central securities depository (CSD) is an institution that holds financial instruments, including equities, bonds, money market instruments and mutual funds. It allows ownership of those instruments to be transferred in electronic form through updating electronic records which are often known as 'book-entry records'.

# Structure of CSDR

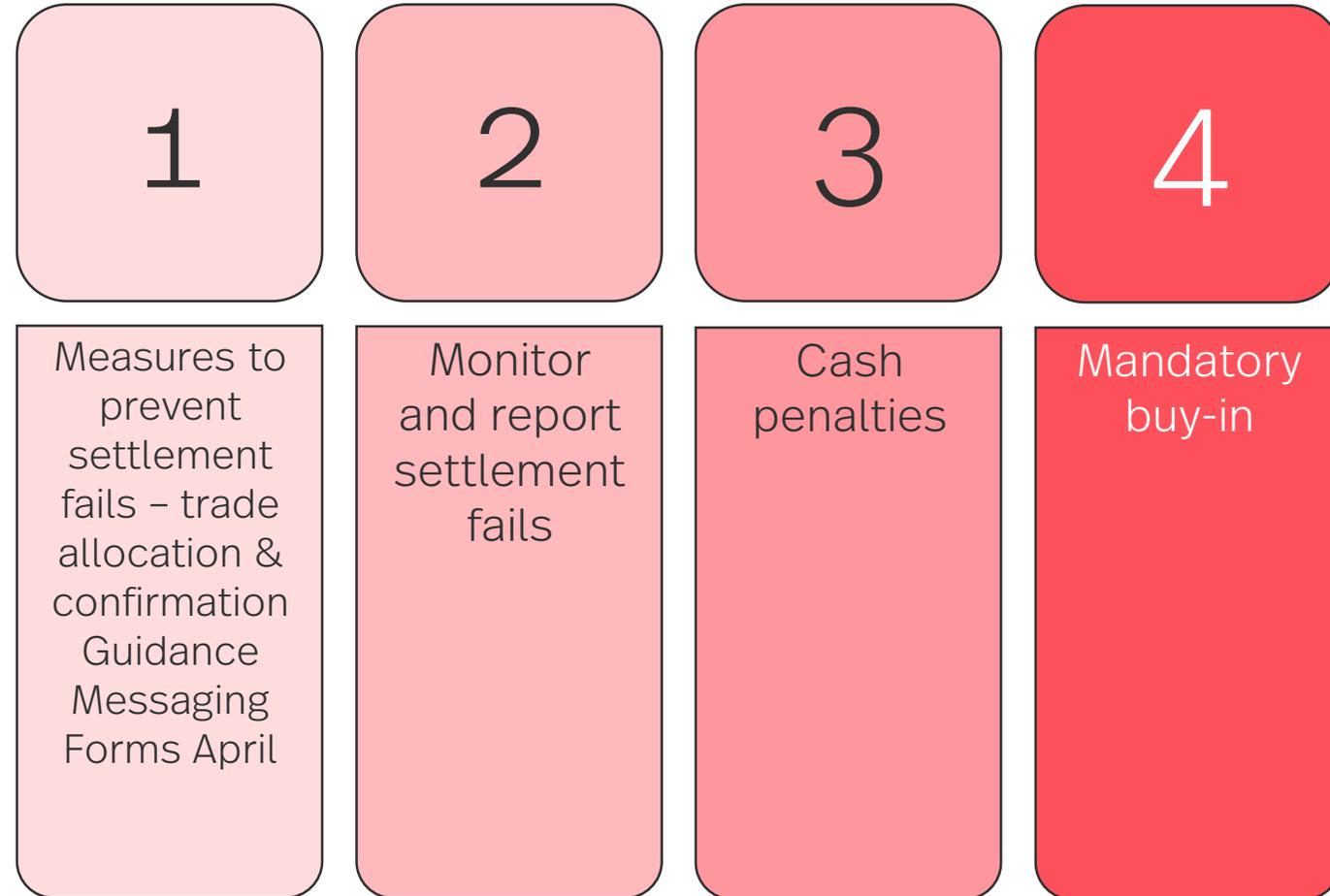
- Securities settlement
- CSD licensing and governance requirements
  - Passporting
  - Third country access
- Banking-type ancillary services
- Sanctions
- Transitional powers

- Level 1
- Level 2
  - RTS CSD Prudential requirements
  - RTS & ITS CSD Authorisation
  - RTS Settlement Discipline
  - RTS & ITS Internalised settlement
  - Delegated Regulation on cash penalties
- Level 3
  - ESMA Guidelines
  - ESMA Q&A

# Regulatory change – Settlement Discipline

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- Aim is to improve settlement of transactions in shares, bonds, funds, MMI & emission allowances
- Transactions:
  - Purchase/sale
  - Collateral management
  - Securities lending/borrowing
  - Repos
  - Other
- Measures apply throughout settlement chain: CSD, CCP, Trading Venues, regulated and unregulated participants and members and their “professional clients”



# Measures to prevent settlement fails



## Settlement failure

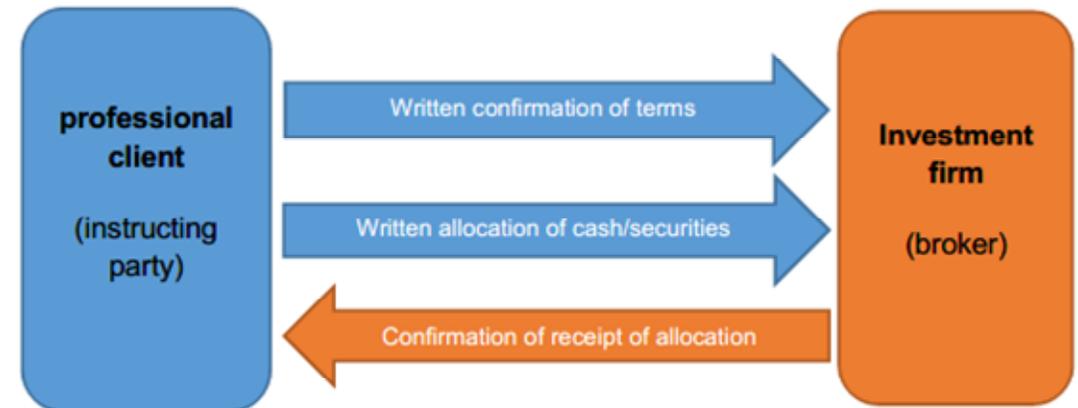
Article 6(2) requires investment firms to take measures to limit the number of settlement fails, including:

- Prompt communication with a **professional client** of an allocation of securities to the transaction;
- Confirmation of that allocation; and
- Confirmation of the acceptance or rejection of terms in good time before the intended settlement date.

ESMA Guidelines on standardised procedures and messaging protocols, 8 October 2019



**Guideline 3:** An investment firm should contractually agree with its professional client on the communication procedures and messaging protocols to be used between them to implement the measures aiming at limiting settlement fails described in Article 6(2) of Regulation (EU) No 909/2014, which measures could be illustrated as follows:



# 1. CSD Rules to prevent settlement fails

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## Article 6 CSDR and Settlement RTS

Measure	Consideration
CSDs shall provide to participants a functionality that supports fully automated, continuous real-time matching of settlement instructions throughout each business day (Art. 5(1) RTS)	Member must use this functionality unless it's a free-of-payment transfer or instruction is already matched by another entity such as a CCP, TV or by CSD itself. Participant must work out which applies.
CSDs must enable bilateral cancellation CSDs to set up a hold and release mechanism to enable instructing parties to hold and block or release pending settlement instructions Recycling instructions until settled or cancelled Partial settlement must be allowed (Art. 7-10 RTS)	Review CSD rules – prescribed methodology?
CSDs must provide real time information on pending settlement instructions that can still be settled; failed settlement; fully-settled; and partially settled. Information must include whether the instruction is matched, partially settled, on hold and reasons for why it is pending or failing. (Art. 11 RTS)	Connectivity to CSD information?

## 2. Monitoring & reporting settlement fails

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CSD annual  
publication –  
aggregated &  
anonymised  
RTS Art. 15

CSD working  
relationships with  
top 10 failing  
participants by  
number and value

RTS Art. 13(2)

Report to  
regulator &  
public by TV,  
CCP or CSD  
Art. 7(9)

CSD to monitor  
settlement fails &  
collect  
information from  
participants  
Art. 7(1)

CSD to regulator  
Monthly general  
information  
Daily & monthly  
settlement fails  
Annual information  
RTS Art. 13 & 14

Suspension  
by TV, CCP  
or CSD  
Art. 7(9)

# 3. Cash penalties

- CSDs to charge cash penalties – meant as a deterrent
- Calculated daily for each business day the transaction fails to settle
- Collect monthly into dedicated account
- Distributed to receiving participants affected by fails
- Single penalties framework published by ECSDA
- Operationally challenging

# 4. Mandatory Buy-in: Timing

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If a failing party does not deliver the financial instruments within a certain number of business days (an extension period) after the intended settlement date (T+2), the relevant entity must initiate a buy-in process. The extension period is:

- 4 business days for liquid shares
- 7 business days for other instruments
- 15 days for transactions on SME markets
- for operations composed of several transactions (**including securities repo or lending agreements**) where the timeframe is sufficiently short and renders the buy-in process ineffective: 30 days.
  - Open repos?

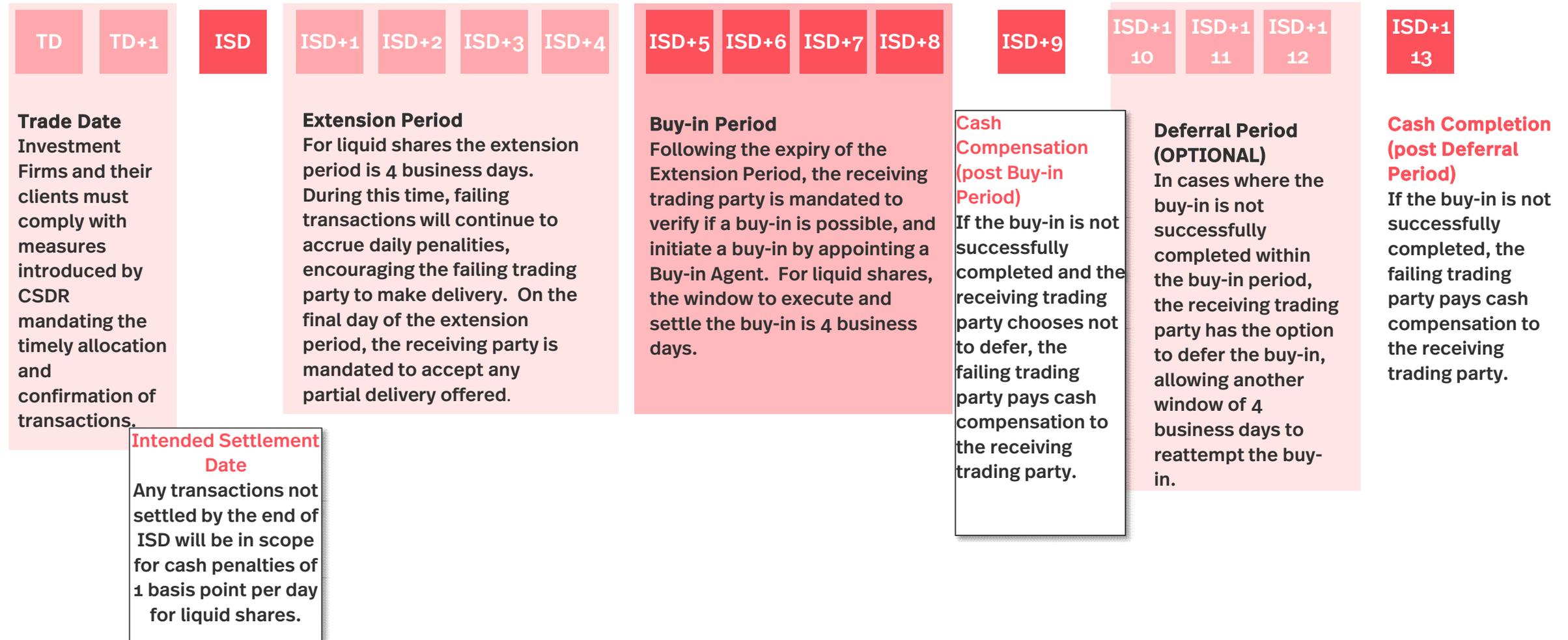
Buy-in must be completed again within 4 or 7 days. Can attempt buy-in again within this deferral period.

At end of deferral period, cash compensation process mandatory

# Lifecycle of a Failing Trade under CSDR

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\*Based on a liquid share with a T+2 settlement cycle



# Mandatory Buy-in: Application

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- Buy-in applies unless “not possible”:
  - Instrument does not exist
  - Trade is not cleared and counterparty subject to insolvency proceedings.
- All parties in the chain of settlement may be subject to the CSDR mandatory buy-in provisions, no matter where the entity is domiciled or incorporated. Significant extra-territorial scope.
- Under RTS Article 25, parties in the settlement chain must ensure that they have established contractual arrangements with their counterparties to legally effect mandatory buy-in.
  - Such contractual arrangements must be enforceable in all relevant jurisdictions.
- CCPs, clearing members, trading venue members and trading parties must establish the necessary procedures to execute the buy-in, pay the cash compensation, the price difference, and the buy-in costs within the required timeframe.
- Buy-in provisions do not apply where the failing participant is a CCP or if insolvency proceedings are opened against the failing participant.

# Buy-In: Responsibility

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Art. 7(10)

	Art. 7(10)(a): cleared	Art. 7(10)(b): TOTV	Art. 7(10)(c): neither cleared nor TOTV
<b>Is buy-in possible?</b>	CCP to check	Receiving TV member to check	Receiving trading parties
<b>Cash compensation?</b>	CCP to inform failing CM	Receiving TV member to inform failing TV member (TV to disclose ID)	Receiving trading party to inform failing trading party
<b>Who will do buy-in?</b>	CCP using auction or buy-in agent	Buy-in agent	Buy-in agent
<b>Can failing participant still deliver securities?</b>	Yes, to buy-in agent with consent Yes, to CCP if it wins auction	Yes, to buy-in agent with consent	Yes, to buy-in agent with consent

# UK position re Brexit and potential delays

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- Industry efforts to delay or de-scope rules and ideally remove mandatory buy-in
- RTS on settlement discipline already delayed once to 1 February 2021 to enable penalty regime to be updated in SWIFT rules – RTS amendment in OJEU
- EU: Latest was a letter response to industry associations from Steven Maijoor 16 April 2020 – no more delay
- UK: Announced not implementing CSDR settlement discipline rules.
- UK: Prefer to use voluntary (industry) settlement discipline rules and consult on any changes
- UK announcement does not solve issues for UK or other counterparties where settlement takes place on an EU CSD – extra-territorial scope.
- EU: ESMA/Commission possibly reconsidering position?
- ICMA FAQs March 2020
- Lack of ESMA Q&A and other guidance

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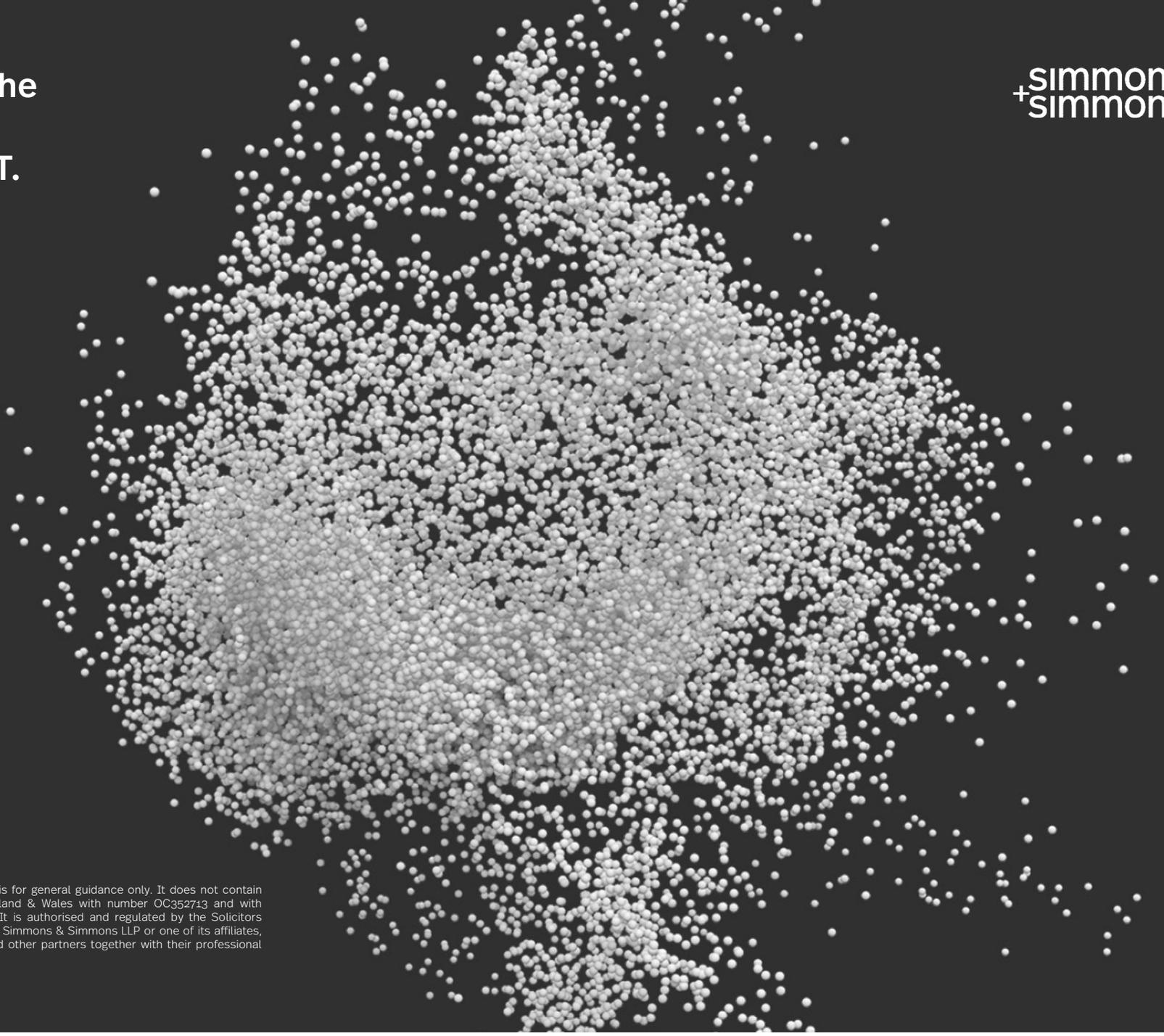
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