Consultation Paper

Guidelines on participant default rules and procedures under CSDR

Q1: Do you consider other stakeholders should be involved in the definition of the default rules and procedures of a CSD? If so, which ones, and what should be the level of their involvement?

A CSD should be allowed to establish its participant default rules and procedures and determine which type of stakeholders it could involve, taking into account considerations of relevance and efficiency. Clearstream does not think that other stakeholders should be added to the proposed list.

In general terms, when developing "participant default rules and procedures" a CSD should first develop on its own these based on its rules and procedures, which should follow the domestic and international legislation in this same domain and suggest such participant default rules relevance and efficiency, and determine which type of stakeholders could be eventually involved in the drafting process, if any. In this regard the CSDR has readily implemented the Governance arrangements that would allow its customers or other stakeholder concerns to be aired (e.g.: User Committee, Art. 28 CSDR).

Participant default rules and procedures are subject to existing EU rules on finality and insolvency, such as the Settlement Finality Directive (SFD), which apply to all FMIs. It is imperative that the adoption of guidelines on CSD participant default rules and procedures by ESMA does not result in situations where CSDs would have to apply different rules from other FMIs in the same jurisdiction.

Q2: Do you think that such acknowledgement process is appropriate? In particular, do you consider it necessary for the CSD to verify the information regarding the default with the designated authority under the SFD before the CSD can take any action, or should the CSD be able to start taking actions based on its reasonable assessment of the participant's situation and on the reliability of the source that informed the CSD in the first place?

Clearstream believes, that the acknowledgement process should be closely aligned to the rules on the recovery and resolution of banks and/or FMIs (once developed for the CSDs specificities), since the management of a participant's default will also inevitably follow these requirements.
The Directive 98/26/EC (SFD) and the settlement finality of the respective CSD are the governing factors/rules that determine the default action. Triggered transactions would indeed still settle between the time the default is declared and the CSD receives that information.

However, the SFD default notification system only (or primarily) works at EU domestic level and therefore non-EU insolvency situations are not notified to the CSDs by the relevant authorities.

Having said the above, Clearstream agrees with Section 3.2 paragraph 8 in that the Guidelines do not prevent the CSD from foreseeing preventive actions in response to other special situations (such as the contractual default or resolution of a participant) in addition to the opening of formal insolvency

proceedings against a participant. On the other hand, Clearstream does think that it is neither reasonable nor practical that a CSD should verify the information of a participant's insolvency if received from one of those sources listed in paragraph 14.

In this regard, we support the information flow suggested by our industry association, ECSDA, which support a more appropriate information flow to be developed and which would involve the generation and transmission of a default notice by the insolvency judge to the supervisor of the default entity, who should inform all operators of payment, clearing and settlement systems in which the default entity participates. This channel would apply equally to all operators and the adoption of these guidelines by CSDs would not end in a situation where CSDs would have to apply different rules from other market infrastructure operators, as is the case today.

Clearstream has reservations that it would be legally secure for the CSD to act on a customer or 3rd party information in this regard. Our reading of paragraph 17 of the consultation document seems to validate this understanding, but the text could be more explicit.

Clearstream does not agree with the acknowledgement process as foreseen in paragraph 17. It is our view, that such process should not be made unnecessarily long and complex so as to enable a rapid response by the CSD and thus ensure proper protection of its interests and those of its non-defaulting participants. The CSD should be able to take actions based on its reasonable assessment of the defaulting participant's situation and on the reliability of the source(s) that informed the CSD without the need for prior verification or acknowledgment, especially because the CSD might have participants incorporated in non-EU countries. Otherwise, the CSD would lose precious time and would be exposed to high risk as the default measure would not be implemented in a timely manner.

Clearstream believes it is important to include a reasonable timeframe in which the CSD should transmit the information to its competent authority and through which secure communication channels.

In Clearstream's view, further clarification is required for guideline 18 according to which a CSD is required to submit "information of any risks the default might entail". In its present form, the requirement is vague and open to interpretation, hence calibration in this regard should be considered. The priority of regulators should be to receive timely and objective information on a default, rather than a detailed risk analysis. ESMA might want to consider revising guideline 18 along the following lines:

> "*the CSD should, as soon as possible, identify and transmit to its competent authority at least the following information:*
>
> - *the type of participant in respect of which the default has occurred,*
> - *the value and volume of the defaulting participant's settlement instructions that are pending settlement and if possible of those that may fail to settle,*
> - *the type of transactions and financial instruments those instructions relate to,*
> - *the number of clients concerned, as well as*
> - *information on any* **material** *risks such default might* **reasonably** *entail."*

Q3: Do you consider that the actions listed are appropriate, or that other actions should be listed? Should certain actions be mandatory, depending for instance on the type or size of default, the characteristics of the participant or the CSD or any other criteria?

The actions listed in the consultative document are appropriate, considering that the CSD will adapt its own measures under (a) and (b) on a case-by-case basis. In Clearstream's view, no actions should be mandatory; they should be decided by the Executive Board of the CSD depending of the specific situation of the participant's default, and based on the agreed rules. In our experience, it neither possible to foresee and pre-define all possible consequences of the measures applied (as required by guideline 20), nor helpful to act in the event of a default in an overly pre-defined way.

Again any guidelines in this respect should take the SFD rules into consideration when implementing termination or suspension of participant's rules, as an insolvent CSD participant is still obliged under SFD to comply with the requirements applying to transfer orders that have reached final status according to this same Directive. In general terms the suspension principle might indeed a more prudent solution, as it puts on hold the CSD participant's operations for a short period to fully understand the consequences of the participant's default, and subsequently allow the administrator to act promptly. However, any such decision can only be made in cooperation with the NCA.

Q4: Do you think other items should be included in the internal plans?

In general terms the ESMA's approach of specifying a non-mandatory and non-exhaustive list of actions to be included in CSD participant default rules and procedures seems appropriate, we refer to the specific comments raised by our association ECSDA in this regards, which we fully support.

In addition to the comments, mentioned above, we would like to highlight that paragraph 21 is quite restrictive as it states, *"The CSD should specify the criteria for applying* ***each of the actions listed in its default rules and procedures to address a participant's default.***" Clearstream would like to suggest to ESMA that the criteria for action to be applied should rather have general framework in order to enable the CSDs to be flexible where appropriate.

Considering all CSD operating in Europe are subject to the CSD-R, which readily requires CSDs to have sufficient operational capacity and competent personnel to support all its activities, the requirements under paragraph 22 seem to duplicate these CSD-R requirement.

Further, Clearstream is contrary to the requirement to produce an "internal plan" in addition to the default rules and procedures proposed. It is our opinion that a general framework will enable the CSD to be flexible where and when appropriate. Furthermore, reference to non-defaulting participants should be deleted from paragraph 23. Non-defaulting participants are not liable for other defaulting participants and have therefore no role to play in the default procedures which are mainly restricted to internal stakeholders.

Clearstream draws the attention to the fact that data confidentiality requirements should be duly considered when referring to reporting default information in paragraph 25. The disclosure of personal data to the competent authority, the relevant authorities and ESMA should remain relevant

with respect to the information provided under the par. 24 (b) which refers to timing and mechanisms and in compliance with the data protection principles applicable to the CSDs.

All CSD stakeholders should be in scope to such rules, hence these procedures should also apply to CSDs as participants (irrespective of whether these CSDs are operated by Central Banks or other private or public entities).

Q5: Do you think that information on the implementation of the default rules and procedures should be transmitted to other stakeholders? If so, which other stakeholders?

Clearstream generally does not think that the information on the implementation of the default measures should be transmitted to other external stakeholders. Every participant is informed of measures which would be taken upon its potential default, and this is readily established through the present contractual documentation. All default measures will be applied as soon as the CSD has become aware of the participant default. Hence additional information to the defaulted participant, unless specifically requested through the contractual documentation, would rather be cumbersome than helpful.

The information on the applied default rules and procedures is restricted to the internal stakeholders and it is not recommended to share these with other stakeholders, unless a non-defaulting participant has pending settlement activity with the defaulting participant.

In the case of CSDs, the role of their T2S participation should not be neglected. Any future guidelines should take into account a necessary T2S alignment process between all participating members in T2S (Namely CSDs, NCBs and the ESCB). This is for uniform default rules and procedures to exist for a commonly used settlement platform like T2S to ensure application of harmonized rules in case of an insolvency affecting participants and CSDs in different countries. The so called T2S Collective Agreement takes into account operational and legal requirements for the insolvency of participants in a domestic and in a cross-border context and should be considered by ESMA in context of these guidelines.

Also as CSDs may be operating on the central bank accounts of participants, we believe that central banks should be generally involved in the process.

Today, the competent authorities are systematically informed of the implemented measures, but disclosure requirements could indeed be further formalised to include transparency as well as the reporting frequency in scope in the list of actions.

Clearstream strongly disagrees with the implementation of guideline 26, as a CSD should be able to implement discretionary pre- and post-default measures without the approval of the competent authority, any as this would delay the implementation of default procedures, which otherwise could potentially put the CSD itself in danger. We strongly suggest deleting the requirement.

Q6: Do you think that such testing and reviewing processes are appropriate?

Clearstream supports the testing and reviewing processes as described, these appear to be appropriate all but the compulsory the involvement of external stakeholders. The CSD should have

the flexibility to define the participants which could participate to the tests in accordance with the stakeholders themselves assigned to the default rules and procedures.

All test results are available upon request of competent and relevant authorities.

Finally, we suggest deleting paragraph 29 (and in other parts of the guidelines) which suggest that "participants holding different types of accounts (omnibus and segregated)" would be benefitting from a different quality of protection. All accounts forms in a CSD provide the same possibility for client assets to be clearly recognisable and ring-fenced from the participant's own assets (and thus from the risk of liquidation), which in fact make no difference in the testing process.