

Consultation Paper

Technical Advice on the Scope of CSDR Settlement Discipline

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex I. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale;
- provide evidence (including relevant data, where applicable) to support the views expressed;
- describe any alternative approaches ESMA should consider.

ESMA will consider all comments received by **9 September 2024**.

All contributions should be submitted online by using the response form available at [ESMA Consultation list | European Securities and Markets Authority \(europa.eu\)](#).

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading '[Data protection](#)'.

Who should read this paper?

All interested stakeholders are invited to respond to this consultation paper. In particular, ESMA invites CSDs and CSD participants, as well as other stakeholders that may be impacted by the CSDR settlement discipline to respond to this consultation paper.

Legislative References

CSDR¹	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
CSDR Refit²	Regulation (EU) No 2023/2845 of the European Parliament and of the Council of 13 December 2023 amending Regulation (EU) No 909/2014 as regards settlement discipline, cross-border provision of services, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories and amending Regulation (EU) No 236/2012
MiFID II³	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast)
MiFIR	Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012
ESMAR⁴	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

¹ OJ L 257, 28.8.2014, p. 1

² OJ L, 2023/2845, 27.12.2023

³ OJ L 173, 12.6.2014, p. 349

⁴ OJ L 331, 15.12.2010, p. 84

Commission Delegated Regulation (EU) 2017/389⁵

Commission Delegated Regulation (EU) 2017/389 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council as regards the parameters for the calculation of cash penalties for settlement fails and the operations of CSDs in host Member States

RTS on CSD Requirements

Commission Delegated Regulation (EU) 2017/392 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on authorisation, supervisory and operational requirements for central securities depositories

RTS on Settlement Discipline⁶

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

Commission Delegated Regulation (EU) 2021/70⁷

Commission Delegated Regulation (EU) 2021/70 of 23 October 2020 amending Delegated Regulation (EU) 2018/1229 concerning the regulatory technical standards on settlement discipline, as regards its entry into force

⁵ OJ L 65, 10.3.2017, p. 1

⁶ OJ L 230, 13.9.2018, p.1

⁷ OJ L 27, 27.1.2021, p. 1

List of acronyms

CP	Consultation Paper
CSD	Central Securities Depository
ESMA	European Securities and Markets Authority
EC	European Commission
ECB	European Central Bank
ETF	Exchange traded fund
EU	European Union
FoP	Free of Payment
ISIN	International Securities Identification Number
RTS	Regulatory Technical Standards
STP	Straight-through processing
T2S	TARGET2-Securities

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1 Executive Summary

Reasons for publication

One of the changes brought by CSDR Refit refers to the need for further specification in order to make the settlement discipline rules operational and better tailored to the diversity of market operations and transactions that can potentially be subject to the regime.

As such, Article 7(9) of CSDR, as amended by CSDR Refit, empowers the European Commission (EC) to adopt delegated acts to supplement the CSDR by specifying: i) the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction, and ii) the circumstances in which operations are not considered as trading.

In light of the above, ESMA has received a request⁸ to provide technical advice to assist the EC in preparing such a delegated act. ESMA has prepared this Consultation Paper (CP) to consult interested parties for the purpose of elaborating the technical advice to be submitted to the EC.

Respondents to this consultation are encouraged to provide the relevant background information and qualitative and quantitative data on costs and benefits, as well as concrete redrafting proposals, to support their arguments where alternative ways forward are called for. If respondents envisage any technical difficulties in implementing the proposed exemptions from the settlement discipline regime, they are encouraged to provide details regarding the specific technical and operational challenges and specify the costs involved, which are important for the cost-benefit analysis.

Contents

Following a brief introduction on the background (section 2), this CP contains ESMA's assessment and preliminary proposals specifying the scope of operations and transactions subject to the settlement discipline regime (section 3). Annex I includes the summary of questions and Annex II contains the EC mandate for ESMA to develop the technical advice.

Next Steps

ESMA will consider the feedback received to this consultation and expects to publish a final report and submit its technical advice to the EC by 31 December 2024.

⁸ This is an additional request, which is not covered in the [Consultation Paper](#) on Technical Advice on CSDR Penalty Mechanism, published by ESMA in December 2023.

2 Background

1. Regulation (EU) No 909/2014 (CSDR) entered into force on 17 September 2014. CSDR includes a set of measures to prevent and address failures in the settlement of securities transactions (settlement fails), commonly referred to as settlement discipline measures. These measures consist of reporting requirements, cash penalties for central securities depositories' (CSD) participants in case of settlement fails, and mandatory buy-ins where a CSD participant fails to deliver the security within a fixed extension period.
2. CSDR has been recently reviewed, with the objective to ensure that the Regulation remains proportionate, effective and efficient. Regulation (EU) No 2023/2845 (CSDR Refit) entered into force on 17 January 2024.
3. One of the changes brought by CSDR Refit refers to the need for further specification to make the settlement discipline rules operational and better tailored to the diversity of market operations and transactions that can potentially be subject to the regime. In order to ensure a smooth and orderly functioning of the financial markets concerned, the settlement discipline regime should not automatically penalise every individual settlement fail regardless of the context, or the parties involved.
4. As such, Article 7(3) (Measures to address settlement fails) of CSDR, as amended by CSDR Refit, specifies that settlement fails the underlying cause of which is not attributable to the participants in the transactions or operations that are not considered as trading are not subject to the settlement penalty mechanism (Article 7(3), points (a) and (b)).
5. In addition, Article 7a(7), point (a) (Mandatory buy-in process), as introduced by the CSDR Refit, exempts the settlement fails stemming from operations and transactions listed in Article 7(3) from the mandatory buy-in process.
6. Lastly, Article 7(9), as amended by CSDR Refit empowers the EC to adopt delegated acts in accordance with Article 67 to supplement the CSDR by specifying the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction under Article 7(3), point (a), and the circumstances in which operations are not considered as trading under Article 7(3), point (b).
7. The mandate mentioned above sets out the principles which ESMA is invited to take account of when developing its advice, including proportionality and coherence within the regulatory framework of the Union. ESMA is invited to widely consult market participants in an open and transparent manner and to take into account the resulting opinions in its advice. ESMA is also invited to justify its advice by providing a quantitative and qualitative cost-benefit analysis of all the options considered and proposed.

3 Assessment and proposal: scope of operations and transactions subject to the settlement discipline regime

3.1 Interplay with existing measures

8. When analysing the scope of settlement discipline that has been applying prior to CSDR Refit, ESMA has identified some existing Q&As⁹ that may have an impact on the scope of settlement discipline and which ESMA believes may be incorporated in the Level 2 rules to be adopted by the EC under the new mandate granted by CSDR Refit. The respective Q&As are included below.

Settlement Discipline Questions 4 – Cash penalties: scope

Question:

- (a) Are there exceptional situations where the cash penalty mechanism provided for under Article 7(2) of CSDR should not be applied?

Answer:

Yes. In addition to situations where insolvency proceedings are opened against the failing participant in accordance with Article 7(12) of CSDR, cash penalties should not be applied in the following situations where settlement cannot be performed for reasons that are independent from the involved participants:

- i) ISIN suspension from settlement due to a reconciliation issue under Article 65 (2) and (6) of the RTS on CSD Requirements;
- ii) ISIN suspension from trading, such as for example under Article 32(1), Article 52(1), Article 69(2) of MiFID II or Article 40(1) of MiFIR;
- iii) settlement instructions involving cash settlement outside the securities settlement system operated by the CSD if, on the respective day, the relevant payment system is closed for settlement;
- iv) technical impossibilities at the CSD level that prevent settlement, such as: a failure of the infrastructure components, a cyber-attack, network problems, or T2S.

CSDs should report the concrete cases falling in the above-mentioned categories to their competent authorities, and the competent authorities should have the possibility to ask the

⁹ [ESMA70-156-4448 CSDR Q&As \(europa.eu\)](https://esma.europa.eu/press-material/press-news/esma-news/esma70-156-4448-csdr-q&as)

CSDs to apply cash penalties in the future in similar cases, if they consider the non-application of penalties unjustified.

Question:

- (b) How should Article 7(12) of CSDR apply in respect of cash penalties due to, and owed by, a participant against which insolvency proceedings are opened?

Answer:

As of the date of the opening of insolvency proceedings against a participant, Article 7(12) of CSDR applies and, therefore, Article 7(2) shall cease to apply to the settlement fails caused by the insolvent participant and consequently:

- i) Cash penalties should no longer be calculated in respect of settlement fails caused by the insolvent participant;
- ii) Cash penalties calculated in respect of settlement instructions involving the insolvent participant until that date should be managed separately i.e. not be included in the aggregated net amounts referred to in Article 17 of the RTS on Settlement Discipline; and
- iii) Cash penalties should not apply to settlement instructions relating to the liquidation of positions of an insolvent participant.

3.2 Relevant input in the context of the CSDR Review

9. The evidence gathered by the EC during the course of the CSDR review indicates that CSDs might not be operationally able to automatically identify instances that are to be excluded from the scope of the settlement discipline regime.
10. In this regard, among the proposals received during the CSDR review, the ECB suggests in its opinion¹⁰ to clarify the scope of transactions that do not involve “two trading parties”. The ECB argues that free-of-payment securities transfers to accounts at CSDs in the context of the (de)mobilisation of collateral, irrespective of whether those transfers are between private parties or between members of the ESCB and their counterparties, should be excluded from the settlement discipline regime.

¹⁰ Paragraph 1.2, Opinion of the European Central Bank of 28 July 2022 on a proposal for a regulation amending the Central Securities Depositories Regulation, CON/2022/25, Official Journal of the European Union C367/3, 26.09.2022.

11. Furthermore, the targeted consultation supporting the CSDR review¹¹ indicated that a number of other transactions may potentially be out of scope of the settlement discipline regime. For instance, some stakeholders argued that portfolio transfers where the parties delivering and receiving securities are the same should be exempted, while others believed that subjecting primary market trades to the buy-in would be disruptive to those markets.
12. ESMA believes that operations exempted should not break the ‘immunization principle’ that seeks to guarantee that when a counterparty fails to deliver due to the failure to receive from a different counterparty, the former will be credited the same penalties it will be debited.
13. ESMA also acknowledges that only transactions that can be classified by CSDs applying straight through processing (STP) should be declared out of scope. In order to see whether to calculate penalties on a particular operation, CSDs should be able to depend on information available in their systems, for instance in the fields of the settlement instruction messages or in databases of suspended for settlement ISINs. Any other alternative would bring significant operational complexities. As such, CSDs’ input is welcome in respect of the operational implications of the proposals included in this CP.
14. Discerning whether a given circumstance qualifies as trading, often hinges on comprehending the rationale behind the operation. However, ESMA understands that CSDs may not always have access to the underlying information driving these instructions. In this regard, one suggestion could be to make mandatory for all EU CSDs the approach currently in place with respect to T2S settlement instructions, where the field “CD_SEC_TX” of the settlement instruction must be filled with one of the 41 codes allowed by T2S specifying the type of transaction from which the instruction stems. ESMA would like to ask for the stakeholders’ views on which transaction types based on the codes allowed by T2S (or potentially other codes such as ISO transaction codes) should be exempted from settlement discipline measures.

3.3 Proposal

15. ESMA would like to ask for the stakeholders’ views on the preliminary proposals included below. Responses to this CP will be crucial in further calibrating the scope of the settlement discipline regime and will enable ESMA to finalise its technical advice to the EC.

¹¹ “Summary report of the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories, 8 December 2020 – 2 February 2021”. Out of the 58 respondents to questions relating to requirements applying to the settlement of financial instruments, 51 replied that clarifications are necessary. These include public authorities, CSDs, their participants, clients of the participants and associations. See p.38 – p.43.

16. ESMA acknowledges that the implementation costs for each case (ex-ante filtering out vs ex-post exemption via the appeal mechanism) are different. In the context of T2S for instance, the ex-post exemption via the appeal mechanism could be enhanced if new removal reasons are required as currently there are different codes for each exemption reason (ESMA understands that there is already a reason "OTHR" so the enhancement of the appeal mechanism might not even be necessary). ESMA welcomes further information on the operational implications and costs for all CSDs.

3.3.1 Underlying causes of settlement fails that are considered as not attributable to the participants in the transactions

17. ESMA considers that the four cases outlined under answer a) of Settlement Discipline Questions 4 (Cash penalties: scope) of ESMA's Q&As on the implementation of CSDR¹² should not be subject to settlement discipline (including cash penalties, mandatory buy-in and settlement fails reporting), i.e.:

- a) ISIN suspension from settlement due to a reconciliation issue under Article 65 (2) and (6) of the RTS on CSD Requirements;
- b) ISIN suspension from trading, such as for example under Article 32(1), Article 52(1), Article 69(2) of MiFID II or Article 40(1) of MiFIR;
- c) settlement instructions involving cash settlement outside the securities settlement system operated by the CSD if, on the respective day, the relevant payment system is closed for settlement;
- d) technical impossibilities at the CSD level that prevent settlement, such as: a failure of the infrastructure components, a cyber-attack, network problems, technical (IT) issues in the system of the CSD.

18. ESMA also believes that additional scenarios may be considered where settlement cannot be performed or has to be postponed for reasons that are independent from the involved participants, such as:

- i. settlement instructions involving securities under sanctions or anti-money laundering proceedings
- ii. settlement instructions put on hold due to the order issued by a court, the police or similar authority with relevant mandate.

¹² Part III: Settlement Discipline of [ESMA's Q&As on Implementation of the Regulation \(EU\) No 909/2014 on improving securities settlement in the EU and on central securities depositories](#)

Q1: Do you agree with ESMA's proposal regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions? Please specify which cases you agree with and which cases you don't agree with (if applicable). Please justify your answer and provide examples and data where available.

Q2: ESMA would like to ask for the stakeholders' views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions). Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

ESMA's proposal - underlying causes of settlement fails that are considered as not attributable to the participants in the transactions		
	Qualitative description	Quantitative description/ Data
Benefits		
Compliance costs: - One-off - On-going		
Costs to other stakeholders		
Indirect costs		

Q3: Do you have other suggestions regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions? Please justify your answer and provide examples and data where available.

Q4: If you have answered yes to the previous question, please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

Respondent's proposal (if applicable)		
	Qualitative description	Quantitative description/ Data

Benefits		
Compliance costs: - One-off - On-going		
Costs to other stakeholders		
Indirect costs		

Q5: Do any of the exemptions proposed above break the immunization principle? Please provide examples and arguments.

Q6: Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which ones can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs? Please provide examples and arguments.

Please provide details regarding the costs for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

Q7: For exemptions that can be filtered out in advance, do you think that a CSD would prefer to implement this filter or not? Please also consider the potentially very large number of appeals a CSD might have to deal with and also the costs this will entail. Please justify your response.

3.3.2 Circumstances in which operations are not considered as trading

19. ESMA is of the opinion that the following circumstances should not be considered as trading for the purpose of the application of both cash penalties and the mandatory buy-in regime:

- a. free-of-payment (FoP) securities transfers to securities accounts at CSDs in the context of the (de)mobilisation of collateral;
- b. market claims, corporate actions on stock, such as cash distributions (e.g. cash dividend, interest payment), securities distributions (e.g. stock dividend; bonus issue), reorganisations (e.g. conversion, stock split, redemption, tender offer);
- c. the process of technical creation of securities, meaning the transfer from the CSD's issuance account to the issuer's CSD account;

- d. creation and redemption of fund units on the primary market, meaning the technical creation and redemption of fund units (except for ETFs);
- e. realignment operations.

20. For the sake of clarity, ESMA does not think that a failed delivery on a market sale transaction caused by the delay in issuing the instrument on the primary market or restrictions during a corporate action should be considered as excluded from the application of both cash penalties and the mandatory buy-in regime.

Q8: Do you agree with ESMA’s proposal regarding the circumstances in which operations are not considered as trading? Please specify which cases you agree with and which cases you don’t agree with (if applicable). Please justify your answer and provide examples and data where available.

Q9: ESMA would like to ask for the stakeholders’ views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the circumstances in which operations are not considered as trading). Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

ESMA’s proposal - circumstances in which operations are not considered as trading		
	Qualitative description	Quantitative description/ Data
Benefits		
Compliance costs: - One-off - On-going		
Costs to other stakeholders		
Indirect costs		

Q10: Do you have other suggestions regarding circumstances in which operations are not considered as trading? Please justify your answer and provide examples and data where available.

Q11: If you have answered yes to the previous question, please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the

table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

Respondent's proposal (if applicable)		
	Qualitative description	Quantitative description/ Data
Benefits		
Compliance costs: - One-off - On-going		
Costs to other stakeholders		
Indirect costs		

Q12: Do any of the exemptions proposed above break the immunization principle? Please provide examples and arguments.

Q13: Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which ones can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs? Please provide examples and arguments.

Please provide details regarding the costs for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

Q14: For exemptions that can be filtered out in advance, do you think that a CSD would prefer to implement this filter or not? Please also consider the potentially very large number of appeals a CSD might have to deal with and also the costs this will entail. Please justify your response.

Q15: Which transaction types based on the codes allowed by T2S (or potentially other codes such as ISO transaction codes) should be exempted from settlement discipline measures? Please provide the codes, their definition and arguments to justify the exemption.

4 Annexes

4.1 Annex I – Summary of Questions

A) Underlying causes of settlement fails that are considered as not attributable to the participants in the transactions

Q1: Do you agree with ESMA’s proposal regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions? Please specify which cases you agree with and which cases you don’t agree with (if applicable). Please justify your answer and provide examples and data where available.

Q2: ESMA would like to ask for the stakeholders’ views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions). Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

ESMA’s proposal - underlying causes of settlement fails that are considered as not attributable to the participants in the transactions		
	Qualitative description	Quantitative description/ Data
Benefits		
Compliance costs: - One-off - On-going		
Costs to other stakeholders		
Indirect costs		

Q3: Do you have other suggestions regarding the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions? Please justify your answer and provide examples and data where available.

Q4: If you have answered yes to the previous question, please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the

table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

Respondent's proposal (if applicable)		
	Qualitative description	Quantitative description/ Data
Benefits		
Compliance costs: - One-off - On-going		
Costs to other stakeholders		
Indirect costs		

Q5: Do any of the exemption proposed above breaks the immunization principle? Please provide arguments.

Q6: Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which ones can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs?

Please provide details regarding the cost for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

Q7: For exemptions that can be filtered out in advance, do you think that a CSD would prefer to implement this filter or not? Also considering the very large number of appeals they might have to deal with and also the costs it will entail.

B) Circumstances in which operations are not considered as trading

Q8: Do you agree with ESMA's proposal regarding the circumstances in which operations are not considered as trading? Please specify which cases you agree with and which cases you don't agree with (if applicable). Please justify your answer and provide examples and data where available.

Q9: ESMA would like to ask for the stakeholders' views on the costs and benefits of the implementation of the respective exemptions from settlement discipline (based on the circumstances in which operations are not considered as trading). Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

ESMA's proposal - circumstances in	
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which operations are not considered as trading		
	Qualitative description	Quantitative description/ Data
Benefits		
Compliance costs: - One-off - On-going		
Costs to other stakeholders		
Indirect costs		

Q10: Do you have other suggestions regarding circumstances in which operations are not considered as trading? Please justify your answer and provide examples and data where available.

Q11: If you have answered yes to the previous question, please specify what costs and benefits you envisage related to the implementation of your proposal. Please use the table below. Where relevant, additional tables, graphs and information may be included in order to support some of the arguments or calculations presented in the table below.

Respondent's proposal (if applicable)		
	Qualitative description	Quantitative description/ Data
Benefits		
Compliance costs: - One-off - On-going		
Costs to other stakeholders		
Indirect costs		

Q12: Do any of the exemption proposed above breaks the immunization principle? Please provide arguments.

Q13: Which of the exemptions proposed above do you think can be filtered out before penalties are applied in an automated way? And which one can only be exempted ex-post, as part of the already existing appeal mechanism at CSDs?

Please provide details regarding the cost for ex-ante filtering compared to ex-post exemption via the appeal mechanism.

Q14: For exemptions that can be filtered out in advance, do you think that a CSD would prefer to implement this filter or not? Also considering the very large number of appeals they might have to deal with and also the costs it will entail.

Q15: Which transaction types based on the codes allowed by T2S (or potentially other codes such as ISO transaction codes) should be exempted from settlement discipline measures? Please provide the codes, their definition and arguments to justify the exemption.

4.2 Annex II – EC Mandate regarding Technical Advice on possible delegated act specifying the scope of operations and transactions subject to the settlement discipline regime

REQUEST TO THE EUROPEAN SECURITIES AND MARKETS AUTHORITY (ESMA) FOR TECHNICAL ADVICE ON POSSIBLE DELEGATED ACT SPECIFYING THE SCOPE OF OPERATIONS AND TRANSACTIONS SUBJECT TO THE SETTLEMENT DISCIPLINE REGIME (Ref: Ares(2023)8061362 – 27/11/2023)

Commission Delegated Regulation (EU) 2018/1229

With this mandate, the European Commission seeks ESMA's technical advice on a possible new delegated act supplementing Regulation (EU) No 909/2014 (Central Securities Depositories Regulation (CSDR))¹³ specifying further the scope of operations and transactions subject to the settlement discipline regime. This delegated act should be adopted in accordance with Article 290 of the Treaty on the Functioning of the European Union (TFEU). The Commission reserves the right to revise and/or supplement this mandate. The technical advice received on the basis of this mandate should not prejudice the Commission's final decision. The provisional mandate reflects the revision of the CSDR, as agreed by the European Parliament and the Council on 27 June 2023. In addition, the mandate should take account of the Communication from the Commission to the European Parliament and the Council – Implementation of Article 290 of the Treaty on the Functioning of the European Union (the "**290 Communication**")¹⁴, and the Framework Agreement on Relations between the European Parliament and the European Commission (the "**Framework Agreement**")¹⁵.

According to the agreed draft text of Article 7(9) of the revised CSDR, the Commission will be empowered to adopt delegated acts in accordance with Article 67 CSDR to specify the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction (Article 7(3), point (a)) and the circumstances in which operations are not considered as trading (Article 7(3), point (b)). Specific provisions in the CSDR text, namely Article 7(3) and Article 7a(7)(a), exempt these operations and transactions from the scope of the cash penalties and mandatory buy-ins, respectively. The experience gathered by the European Commission and the relevant European and national competent authorities in operating the settlement discipline regime indicate that exemptions from the settlement discipline regime require further operationalisation and clarification in order to allow for an efficient and effective operation of the settlement system by the central securities depositories. The European Parliament and the Council shall be duly informed about this mandate.

In accordance with Declaration 39 on Article 290 TFEU, annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December

¹³ 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.

¹⁴ Communication of 9.12.2009. COM (2009) 673 final.

¹⁵ OJ L 304, 20.11.2010, p. 47.

2007, and in accordance with the established practice within the European Securities Committee¹⁶, the Commission will continue, as appropriate, to consult experts appointed by the Member States in the preparation of possible delegated acts in the financial services area. In accordance with point 15 of the Framework Agreement, the Commission will provide full information and documentation on its meetings with experts appointed by the Member States within the framework of its work on the preparation and implementation of Union legislation, including soft law and delegated acts. Upon request by the Parliament, the Commission may also invite Parliament's experts to attend those meetings. The powers of the Commission to adopt delegated acts are subject to Article 67 CSDR. As soon as the Commission adopts a proposed delegated act, the Commission will notify it simultaneously to the European Parliament and the Council.

Context

Scope

The Central Securities Depositories Regulation (CSDR) includes a set of measures to prevent and address failures in the settlement of securities transactions (settlement fails), commonly referred to as settlement discipline measures. These measures consist of reporting requirements, cash penalties for central securities depositories' (CSD) participants in case of settlement fails, and mandatory buy-ins where a CSD participant fails to deliver the security within a fixed extension period. Cash penalties are applied to all failing settlement instructions in EU CSDs since 1 February 2022, while the implementation of the mandatory buy-in process has been temporarily suspended.¹⁷

Many and diverse transactions and operations are undertaken in EU capital markets. Not all of these transactions and operations should necessarily be subject to the provisions of the settlement regime. Simultaneously, improving the functioning of, and further integrating the post-trade landscape in, the EU is one of the objectives of the Capital Markets Union¹⁸. Therefore, an effective, efficient, and proportionate settlement discipline regime should discourage failed settlement instructions. However, this regime should not cover the cases where the settlement discipline measures would not be practicable or could lead to detrimental consequences for the market. In addition, settlement instructions which fail due to reasons not attributable to the participants in the transaction or operation should not be covered either.

In March 2022, the Commission proposed a review¹⁹ of CSDR, including of the provisions related to settlement discipline. The objective was to ensure that the Regulation remains proportionate, effective and efficient. The targeted public consultation supporting the review as

¹⁶ Commission's Decision of 6.6.2001 establishing the European Securities Committee, OJ L 191, 17.7.2001, p.

¹⁷ Commission Delegated Regulation (EU) 2022/1930 of 6 July 2022 amending the regulatory technical standards laid down in Delegated Regulation (EU) 2018/1229 as regards the date of application of the provisions related to the buy-in regime

¹⁸ Communication from the Commission, A Capital Markets Union for people and businesses – New Action Plan, COM (2020) 590 final

¹⁹ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 909/2014 as regards settlement discipline, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories, COM (2022) 120, Brussels, 16.03.2022.

well as the subsequent opinion²⁰ of the European Central Bank (ECB) regarding the Commission's proposal indicated that the settlement discipline regime requires further specification in order to make the rules operational and better tailored to the diversity of market operations and transactions that can potentially be subject to the regime.

On 23 June 2023, the Council and Parliament reached a provisional agreement to update the rules on central security depositories (CSDs)²¹. The new Regulation will contain measures to improve settlement efficiency by amending certain elements of the settlement discipline regime, including by reducing compliance costs and regulatory burdens. Furthermore, to ensure a smooth and orderly functioning of the financial markets concerned, the settlement discipline regime should not automatically penalise every individual settlement fail regardless of the context, or the parties involved.

As such, Article 7(3) (Measures to address settlement fails), as amended by the CSDR review, will specify that settlement fails the underlying cause of which is not attributable to the participants in the transactions or operation that are not considered as trading are not subject to the settlement penalty mechanism (Article 7(3), points (a) and (b)). In addition, Article 7a(7), point (a) (Mandatory buy-in process), as introduced by the CSDR review, exempts the settlement fails stemming from operations and transactions listed in Article 7(3) from the mandatory buy-in process. Lastly, Article 7(9), as amended by the CSDR review will empower the Commission to adopt delegated acts in accordance with Article 67 to supplement the CSDR by specifying the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction under paragraph Article 7(3), point (a), and the circumstances in which operations are not considered as trading under Article 7(3), point (b).

These provisions require further specification in order to ensure a proportionate, effective and efficient implementation of the settlement discipline regime. The evidence gathered during the course of the CSDR review indicates that CSDs might not be operationally able to identify settlement instructions that are to be excluded from the scope of the regime. For instance, the ECB suggests in its opinion to clarify the scope of transactions that do not involve "two trading parties". The ECB argues that free-of-payment securities transfers to accounts at CSDs in the context of the (de)mobilisation of collateral, irrespective of whether those transfers are between private parties or between members of the ESCB and their counterparties, should be excluded from the settlement discipline regime²². Furthermore, the targeted consultation supporting the CSDR review²³ indicated that a number of other transactions may potentially be out of scope of the settlement discipline regime. For instance, some stakeholders argued that portfolio transfers where the buyer and seller are the same should be exempted, while others believed that subjecting primary market trades to the buy-in would be disruptive to those markets.

²⁰ Opinion of the European Central Bank of 28 July 2022 on a proposal for a regulation amending the Central Securities Depositories Regulation, CON/2022/25, Official Journal of the European Union C367/3, 26.09.2022

²¹ "Central Securities Depositories: Council and Parliament reach agreement", Council of the EU, Press Release, 27 June 2023

²² Paragraph 1.2, Opinion of the European Central Bank of 28 July 2022 on a proposal for a regulation amending the Central Securities Depositories Regulation, CON/2022/25, Official Journal of the European Union C367/3, 26.09.2022.

²³ "Summary report of the targeted consultation document on the review of regulation on improving securities settlement in the European Union and on central securities depositories, 8 December 2020 – 2 February 2021". Out of the 58 respondents to questions relating to requirements applying to the settlement of financial instruments, 51 replied that clarifications are necessary. These include public authorities, CSDs, their participants, clients of the participants and associations. See p.38 – p.43.

In light of the above, the Commission asks ESMA to provide a technical advice on a Commission Delegated Act specifying (i) the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction and (ii) the circumstances in which operations are not to be considered as trading. In its advice, ESMA should ensure that its approach, while specifying the exemptions under Article 7(3), is effective and proportionate. Specifically, ESMA should consider addressing market behaviour that leads to settlement inefficiencies, but without automatically penalising every individual settlement fail regardless of the context and parties involved. The advice should allow for easy identification of transactions and operations that are out of scope of the settlement discipline regime and hence reduce the administrative burden and compliance costs for CSDs. It should, however, not compromise the overall objective of the CSDR, namely, to incentivise the settlement of transactions on the intended settlement date with a minimum exposure of its participants to counterparty and liquidity risks and a low rate of settlement fails²⁴.

Principles that ESMA should take into account

On the working approach, ESMA is invited to take account of the following principles:

- The principle of proportionality: the technical advice should not go beyond what is necessary to achieve the objective of the Regulation. It should be simple and limit to the largest extent possible financial, administrative, or procedural burdens for counterparties and financial infrastructure providers, in particular CSDs.
- When preparing its advice, ESMA should seek coherence within the regulatory framework of the Union.
- In accordance with the Regulation of the European Parliament and the Council establishing a European Securities and Markets Authority (the "ESMA Regulation")²⁵, ESMA should not feel confined in its reflection to elements that it considers should be addressed by the amendment to the delegated act but, if it finds it appropriate, it may indicate guidelines and recommendations which, in its view, could be appropriate to accompany the delegated act to better ensure its effectiveness.
- ESMA will determine its own working methods depending on the content of the provisions being dealt with. Nevertheless, horizontal questions should be dealt with in such a way as to ensure coherence between different standards of work being carried out by the various expert groups.
- In accordance with the ESMA Regulation, ESMA should, where relevant, involve the European Banking Authority and the European System of Central Banks in order to ensure cross-sectoral consistency. It should also cooperate, where relevant, with the European Systemic Risk Board on any issues related to systemic risk.

²⁴ Art. 6(3) CSDR

²⁵ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), OJ L 331, 15.12.2010, p. 84.

- In accordance with the ESMA Regulation, ESMA is invited to widely consult market participants in an open and transparent manner. ESMA should provide a detailed feedback statement on the consultation, specifying when consultations took place, how many responses were received and from whom, as well as the main arguments for and against the issues raised. This feedback statement should be annexed to its technical advice. The technical advice should justify ESMA's choices *vis-à-vis* the main arguments raised during the consultation.

- ESMA is invited to justify its advice by providing a quantitative and qualitative cost-benefit analysis of all the options considered and proposed. ESMA should provide the Commission with a description of the problem, the objectives of the technical advice, possible options for consideration and a comparison of the main arguments for and against the considered options. The cost-benefit analysis should justify ESMA's choices *vis-à-vis* the main considered options.

- ESMA's technical advice should not take the form of a legal text. However, ESMA should provide the Commission with a clear and structured ("articulated") text, accompanied by sufficient and detailed explanations. Furthermore, the technical advice should be presented in an easily understandable language respecting current terminology in the Union.

- ESMA should provide comprehensive technical analysis on the subject matters described in section 3 below, where these are covered by the delegated powers included in:

- the relevant provision of the Regulation as amended;
- the corresponding recitals; or
- the relevant Commission's request included in this mandate.

- ESMA should address to the Commission any question to clarify the text of the Regulation or the relevant Regulatory Technical Standard it considers of relevance to the preparation of its technical advice.

Procedure

The Commission is requesting ESMA's technical advice in view of the preparation of a Commission Delegated Act specifying (i) the underlying causes of settlement fails that are considered as not attributable to the participants in the transaction and (ii) the circumstances in which operations are not to be considered as trading.

The mandate takes into account the CSDR (Articles 7(9) and 67), the ESMA Regulation, the Communication on the implementation of Article 290 of the Treaty on the Functioning of the

European Union (TFEU)²⁶ and the Framework Agreement on relations between the European Parliament and the European Commission²⁷.

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

In accordance with established practice, the Commission may continue to consult experts appointed by the Member States in the preparation of the amendment to the delegated act.

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

ESMA is invited to provide technical advice on the following issues

ESMA is invited to provide technical advice to assist the Commission in preparing a Commission Delegated Act to specify (i) the underlying causes of settlement fails that are considered as not attributable to the participants in the transactions and (ii) the circumstances in which operations are not considered as trading, both in accordance with Article 7(3), point (a), and (9) as amended by the CSDR review. In particular, in order to ensure a proportionate, effective and efficient implementation of the settlement discipline regime the advice should clearly define criteria, i.e. the type, circumstances and parties involved to transactions and operations, which do not justify inclusion of the particular transaction and/ or operation in the scope of the settlement discipline regime. In its reflections, ESMA should also consider whether the specific conditions for exemptions of a particular transactions and/ or operation equally justify exemption from both the cash penalties regime as well as the mandatory buy-in process.

The technical advice should contribute to an effective, efficient, and seamless operation of the settlement discipline regime. However, it should not impede the rigorous application of the settlement discipline regime by expanding excessively and unjustifiably the scope of its exemptions. In its advice ESMA, where appropriate, should take account of the different types of securities, transactions and operations, parties involved and the objective of the transactions and operations or any other criteria it deems necessary. The proposed technical advice should not lead to further fragmentation of the single market for capital, while the identification of the relevant transactions and operations should lend itself to automation by CSDs in order to ensure the seamless and cost-effective operation of post-trade infrastructures. Lastly, the advice provided should reduce compliance costs and regulatory burden put on CSDs and participants to the securities settlement system, without jeopardizing financial stability and resilience of the EU capital markets.

Indicative timetable

²⁶ Communication from the Commission to the European Parliament and the Council - Implementation of Article 290 of the Treaty on the Functioning of the European Union, COM(2009) 673

²⁷ OJ L 304, 20.11.2010, p. 47.

This mandate takes into consideration that ESMA requires sufficient time to prepare its technical advice and that the Commission needs to adopt the amended delegated act according to Article 290 TFEU. The powers of the Commission to adopt delegated acts are subject to Article 67 CSDR that allows the European Parliament and the Council to object to a delegated act within a period of 3 months, extendible by 3 further months at the initiative of the European Parliament or of the Council. The delegated act will only enter into force if neither European Parliament nor the Council have objected on expiry of that period or if both institutions have informed the Commission of their intention not to raise objections.

It is of utmost importance to start the work on this issue as soon as possible. The deadline set to ESMA to deliver the technical advice is therefore 31 December 2024.