



European Securities and
Markets Authority

Consultation Paper

Amendment of Article 19 of CSDR RTS on 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 1. Comments are most helpful if they:

1. respond to the question stated;
2. indicate the specific question to which the comment relates;
3. contain a clear rationale; and
4. describe any alternatives ESMA should consider.

ESMA will consider all comments received by **9 September 2022**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

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, this paper may be specifically of interest to CCPs, CSDs and their clients.



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1 Executive Summary

Reasons for publication

This consultation paper seeks stakeholders' views on a possible amendment to Commission Delegated Regulation (EU) 2018/1229¹ aiming at simplifying the process of collection and distribution of cash penalties for settlement fails relating to cleared transactions under Regulation (EU) No 909/2014 on Central Securities Depositories² (CSDR).

Contents

ESMA's proposal consists in removing the separate process established in Article 19 of the Delegated Regulation (EU) 2018/1229 for the collection and distribution of the cash penalties in relation to settlement fails on cleared transactions to let the CSDs run the entire process of collection and distribution of penalties according to Article 16, 17 and 18 of the same delegated regulation.

Section 2 provides general background to ESMA's proposal, while Sections 3 and 4 present more precisely the issues on which ESMA seeks input from the stakeholders. In particular, ESMA would appreciate an update on the situation, a few months after the application start date of the cash penalties component of the CSDR settlement discipline regime, as well as some concrete feedback on the amendment proposed in Annex IV hereto, and on the possible timing of its implementation.

Next Steps

ESMA will consider the responses it receives to this CP and finalise the amending RTS for submission to the EC in Q4 2022, for endorsement in the form of a Commission Delegated Regulation, i.e. a legally binding instrument applicable in all Member States of the European Union.

Following the endorsement of the draft RTS by the European Commission, the Commission Delegated Regulation will be subject to the non-objection of the European Parliament and of the Council.

¹ 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 (OJ L 230, 13.9.2018, p. 1)

² Central Securities Depositories Regulation – 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 (OJ L 257, 28.8.2014, p. 1–72)



Legislative references

CSDR	Central Securities Depositories Regulation – 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 (OJ L 257, 28.8.2014, p. 1–72)
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 (OJ L 331, 15.12.2010, p. 84).
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 (OJ L 230, 13.9.2018, p. 1)



Acronyms used

CCP	Central Counterparty
CSD	Central Securities Depository
DvP	Delivery versus payment
EACH	European Association of CCP Clearing Houses
EC	European Commission
ESCB	European System of Central Banks
ESMA	European Securities and Markets Authority
NCA	National Competent Authority
RTS	Regulatory Technical Standards
SMSG	Securities and Markets Stakeholders Group

2 Background

1. The CSDR settlement discipline regime includes three main measures to address settlement fails: the reporting of settlement fails, the application of cash penalties and a mandatory buy-in regime.
2. After two postponements³, first for technical reasons impacting the cash penalties regime and then due to the overall impact of the COVID-19 pandemic on the implementation of all regulatory reforms, the settlement discipline regime has entered into force on 1 February 2022.
3. The issue at stake here relates to the process of collection and distribution of cash penalties in respect of cleared transactions.
4. Article 19 of the RTS on settlement discipline establishes a specific framework for the collection and distribution of penalties for cleared transactions by CCPs, in parallel to the general framework established by Article 17 of the same regulation for the collection and distribution of penalties managed by CSDs. Article 7(11) of CSDR, i.e. that CCPs are exempted from penalties in relation to settlement fails relating to transactions for which they interpose themselves between the counterparties⁴. The objective of the said Article 19 was to specify the application of the penalty mechanism for cleared transactions when CCPs are involved, to ensure compliance with Article 7(11) of CSDR.
5. However, CCPs have expressed strong views that CSDs should replace CCPs in this specific mechanism, for the following reasons:
 - a) CSDs can identify and access participants for uncleared and cleared transactions, as all clearing members participate, directly or indirectly (through a settlement agent) in CSDs; the parallel framework for collection and distribution of cash penalties relating to cleared transactions only imposes additional costs and burdensome processes on the CSDs (to calculate cash penalties amount for cleared transactions separately, to liaise with the CCPs and ensure they collect and distribute the cash penalties);
 - b) for CCPs, this parallel framework also adds costs and complexities as they have to make costly technical adaptations to ensure the collection and distribution of penalties and the interactions with the CSDs;
 - c) for the concerned participants who are also clearing members, the parallel framework increases operational risk and liquidity needs. Interacting with a

³ Commission Delegated Regulation (EU) 2020/1212 of 8 May 2020 amending Delegated Regulation (EU) 2018/1229 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline (OJ L 275, 24.8.2020, p. 3–4).

⁴ ESMA CSDR Questions and Answers, Settlement discipline question 6(f) (https://www.esma.europa.eu/sites/default/files/library/esma70-708036281-2_csd_r_qas_1.pdf)

single entity (the CSD) with regards to the single net amount of cash penalties to be paid or received each month would allow to improve that.

6. In its summary report⁵ on the targeted consultation on the review of CSDR, among the main issues raised by “a considerable number of stakeholders”, the EC highlighted that:

“Process of collecting and redistributing cash penalties when a CCP is involved: Several stakeholders, in particular industry associations representing CSDs, CCPs and banks, suggested that the process of collection and redistribution of cash penalties is amended to ensure that one single party processes the collection and distribution of cash penalties. This would imply an amendment to Article 19 of the RTS on settlement discipline. These stakeholders submitted that a duplicative operational process as foreseen in the RTS could create important new risks, particularly cross-border. A single operational process would therefore be preferable according to them.”

7. It appears that a number of respondents, representing a wide range of market participants (CCPs, CSDs, banks), expressed support to the removal of the specific mechanism for cleared transactions referred to in Article 19 of the RTS on settlement discipline and to apply the general process where CSDs would be responsible for the collection and distribution of cash penalties for both cleared and uncleared transactions.
8. In view of the application of the RTS on settlement discipline, the European Association of CCP Clearing houses (EACH) explained to ESMA that CCPs and CSDs have established arrangements allowing them to comply with current Article 19 of the RTS on settlement discipline as of 1 February 2022. They stressed however that such arrangements create unnecessary operational risks and operating costs that a CSD-run cash penalties process would eliminate.
9. Since this input was provided before the entry into force of the CSDR settlement discipline regime, ESMA would like to receive market participants’ confirmation that such simplification of the cash penalties processes for cleared transactions is still relevant after a few months of application of the CSDR cash penalties regime.

Q1: Do market participants support removing the special process of collection and distribution of penalties by CCPs for cleared transactions? Please provide justifications, if possible supported by quantitative data.

⁵ 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 (p.42): https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2020-csdr-review-summary-of-responses_en.pdf

3 Appropriateness of a simplification of the cash penalties process for cleared transactions

10. With the current drafting of Article 19, CSDs obligation is to report penalties on cleared transactions to CCPs. It is then up to CCPs to collect and distribute the penalties on cleared transactions from and to their clearing members and make the necessary reporting to CSDs. CSDs have no means to control what is done on CCPs side.
11. According to the suggested amendment of Article 19 of the RTS on Settlement Discipline, CSDs would collect and distribute directly from participants instead of CCPs the cash penalties due and owed by CCPs' clearing members (as they do for any other participant).
12. Given the interposition role of the CCPs in the cleared transactions between receiving and delivering participants, penalties due and owed in respect of settlement instructions submitted by a CCP to a CSD should always perfectly net themselves and CCPs should never have to actually pay (or receive) any such penalties.
13. However, the case may arise of imbalances that can appear for various reasons on the CCPs' accounts in relation to cleared transactions.
14. According to preliminary discussions with market participants, ESMA understands such imbalances can appear in various, rare, cases such as when the delivery of securities by a clearing member to the CCP is too close to the CSD cut-off time for Delivery versus Payment (DvP) settlement instructions, and does not allow for the settlement of the delivery instructions from the CCP on the intended settlement date. It can also occur in cases of differences in the penalties calculated by CSDs (e.g. for trades on financial instruments that are traded both on SME growth market and on non-SME growth market, which triggers the application of different cash penalties rates).
15. In such cases, imbalanced positions in respect of cleared transactions may remain in the books of the CCPs, resulting in the CCP appearing as the failing participant for the CSD and the net amount of penalties to be collected from, or distributed to, CCPs can be different from zero. ESMA understands that CCPs propose to cover the difference by either mutualising the amount of these penalties among all their clearing members or establishing clear rules to assign the cost to identified clearing members⁶.

⁶ Cf. [EACH CSDR Settlement Discipline Framework](#) – Updated Version, July 2020

16. To comply with Article 7(11) of CSDR, the proposed draft amendment provides that CCPs can recover such imbalances from their clearing members and provide for such mechanism in their rules.

Q2: Do market participants support amending Article 19 of the CDR on Settlement Discipline as suggested in Annex IV? Please provide justifications, if possible supported by quantitative data.

4 Implementation timing

17. From preliminary discussions with market participants, two points should be considered for setting the implementation date of the suggested amendment:
 - a. To limit operational risks in respect of the cash penalties process, the change should occur at the beginning of a given month.
 - b. The need for a delayed implementation date: the required technical changes could be difficult to implement for certain stakeholders which would welcome up to a six-month implementation delay to allow running end-to-end testing with all relevant stakeholders involved in the cash penalties processes.

Q3: Do market participants support delaying the application of the envisaged amendment by six months after the publication of the amending RTS in the Official Journal of the EU? If not, what would be appropriate implementation timeline in your view? Please provide explanations.



5 Annexes

5.1 Annex I - Summary of questions

Q1: Do market participants support removing the special process of collection and distribution of penalties by CCPs for cleared transactions? Please provide justifications, if possible supported by quantitative data.

Q2: Do market participants support amending Article 19 of the CDR on Settlement Discipline as suggested in Annex IV? Please provide justifications, if possible supported by quantitative data.

Q3: Do market participants support delaying the application of the envisaged amendment by six months after the publication of the amending RTS in the Official Journal of the EU? If not, what would be appropriate implementation period in your view? Please provide explanations.

5.2 Annex II - Legislative mandate to develop technical standards

Article 7(15) of Regulation (EU) No 909/2014

Measures to address settlement fails

15. ESMA shall, in close cooperation with the members of the ESCB, develop draft regulatory technical standards to specify:

- (a) the details of the system monitoring settlement fails and the reports on settlement fails referred to in paragraph 1;
- (b) the processes for collection and redistribution of cash penalties and any other possible proceeds from such penalties in accordance with paragraph 2;
- (c) the details of operation of the appropriate buy-in process referred to in paragraphs 3 to 8, including appropriate timeframes to deliver the financial instrument following the buy-in process referred to in paragraph 3. Such timeframes shall be calibrated taking into account the asset type and liquidity of the financial instruments;
- (d) the circumstances under which the extension period could be prolonged according to asset type and liquidity of the financial instruments, in accordance with the conditions referred to in point (a) of paragraph 4 taking into account the criteria for assessing liquidity under point (17) of Article 2(1) of Regulation (EU) No 600/2014;
- (e) type of operations and their specific timeframes referred to in point (b) of paragraph 4 that renders buy-in ineffective;
- (f) a methodology for the calculation of the cash compensation referred to in paragraph 7;
- (g) the conditions under which a participant is deemed consistently and systematically to fail to deliver the financial instruments as referred to in paragraph 9; and
- (h) the necessary settlement information referred to in the second subparagraph of paragraph 10.

ESMA shall submit those draft regulatory technical standards to the Commission by 18 June 2015.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.



5.3 Annex III - Preliminary high-level cost-benefit analysis

Pursuant to the third subparagraph of Article 10(1) of the ESMA Regulation, ESMA shall conduct open public consultations on draft RTS and analyse the potential related costs and benefits, unless such consultations and analyses are highly disproportionate in relation to the scope and impact of the draft RTS concerned or in relation to the particular urgency of the matter.

ESMA has conducted a preliminary high-level analysis of the potential costs and benefits of the proposed amendment, which will be finalised based on the responses to the consultation.

5.3.1 Baseline

The purpose of the amending draft RTS on settlement discipline proposed in Annex IV hereto is to simplify the process of collection and distribution of cash penalties for settlement fails relating to cleared transactions, by making the CSDs responsible for the collection and distribution of cash penalties for all transactions (both cleared and uncleared).

5.3.2 Preliminary cost benefit analysis

On the basis of the analysis below, ESMA concludes that the benefits of amending Article 19 of the RTS on Settlement Discipline outweigh the costs:

Policy objective	Establishing a single harmonised penalties collection and distribution process for settlement fails on all types of transactions, both uncleared and cleared.
Technical proposal	Amending Article 19 of the RTS on Settlement Discipline to remove the special collection and distribution process of penalties currently run by CCPs for cleared transactions by making the CSDs responsible for the collection and distribution of penalties in relation to both cleared and uncleared transactions.
Benefits	The expected impact of the proposed change will represent a relief for market participants through lowering operational risks and the costs of the collection and distribution process by simplifying the process.
Costs	Costs of adapting the market participants' systems, mostly CSDs and CCPs, to the new process. No additional costs are envisaged.



5.4 Annex IV - Draft technical standards

COMMISSION DELEGATED REGULATION (EU) .../..
amending regulatory technical standards laid down in Delegated
Regulation (EU) 2018/1229 as regards the collection and distribution of
cash penalties for cleared transactions

of []

(text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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 236/2012⁷, and in particular Article 7(15) thereof,

Whereas:

- (1) Commission Delegated Regulation (EU) 2018/1229⁸ specifies measures to prevent and address settlement fails, and to encourage settlement discipline. Those measures include monitoring settlement fails and collecting and distributing cash penalties for settlement fails. Delegated Regulation (EU) 2018/1229 also specifies the operational details of the cash penalties regime.
- (2) The entry into force of Delegated Regulation (EU) 2018/1229 was deferred until 1 February 2021 according to Delegated Regulation (EU) 2020/1212⁹ and then to 1 February 2022 according to Delegated Regulation (EU) 2021/70¹⁰.

⁷ OJ L 257, 28.8.2014, p. 1

⁸ 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 (OJ L 230 13.9.2018, p. 1).

⁹ Commission Delegated Regulation (EU) 2020/1212 of 8 May 2020 amending Delegated Regulation (EU) 2018/1229 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline (OJ L 275, 24.8.2020, p. 3–4).

¹⁰ 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 (OJ L 27, 27.1.2021, p. 1–2)

- (3) According to Article 7(11) of Regulation (EU) 909/2014, the cash penalties regime should not apply to failing participants which are central counterparties (CCPs), as defined in Regulation (EU) No 642/2012 of the European Parliament and Council¹¹, which means that CCPs should themselves be subject to penalties only in relation to transactions entered into by a CCP where it does not interpose itself between counterparties.
- (4) With a view to ensure that, in respect of settlement fails relating to cleared transactions, where CCPs interpose themselves between counterparties, cash penalties are not applied to CCPs, Article 19 of Delegated Regulation (EU) 2018/1229 provides for a specific collection and distribution process for cash penalties to be carried out by CCPs, which can directly collect and distribute penalties from and to their own clearing members.
- (5) However, both CCPs and CSDs, as well as their members and participants, have indicated that the implementation of this specific process by CCPs adds risks, technical complexities and costs to the process of collection and distribution of cash penalties for settlement fails relating to cleared transactions. To facilitate the collection and distribution of penalties from and to clearing members, while also reducing the risks and the cost related to such process, it is desirable that the process is conducted by CSDs under the general process for collection and distribution of penalties established in Article 17 of Delegated Regulation (EU) 2018/1229.
- (6) CCPs and CSDs further confirmed that penalties for settlement fails relating to cleared transactions could be fully calculated, applied, collected and redistributed by CSDs, from and to all the participants identified in the latter settlement instructions, in accordance with Articles 16, 17 and 18 of Delegated Regulation (EU) 2018/1229, as any other penalties for settlement fails relating to uncleared transactions.
- (7) Where CCPs interpose themselves between failing and receiving CSD participants, the net amount of penalties that CSDs would have to collect from or distribute to CCPs should amount to zero. However, in certain cases such as a delivery of securities to the CCP too close to the DvP cut-off time, which does not allow for the settlement of the delivery instructions from the CCP, or in cases of differences in the penalties calculated by different CSDs, or extensions of their settlement cycle by CSDs which do not allow for partial settlements, imbalanced positions in respect of cleared transactions may remain in the books of the CCPs and the net amount of penalties to be collected from, or distributed to, CCPs can be different from zero. In such cases, the CCPs may allocate the penalties' amount, credit or debit, to their clearing members and provide for the relevant mechanism in their rules to that effect.

¹¹ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1–59)



- (8) Article 19 of Delegated Regulation (EU) 2018/1229 should therefore be amended accordingly.
- (9) Given the technological adaptations required in CCPs and CSDs' systems to implement with this change of process, the application of this amendment should be deferred by six months.
- (10) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Securities and Markets Authority (ESMA).
- (11) In developing the draft regulatory technical standards, ESMA has also cooperated with the members of the European System of Central Banks.

HAS ADOPTED THIS REGULATION:

Article 1
Amendment to Delegated Regulation (EU) 2018/1229

Delegated Regulation (EU) 2018/1229 is amended as follows:
Article 19 is replaced by the following:

“Article 19
Penalty mechanism for transactions cleared by CCPs

With respect to settlement fails related to transactions cleared by CCPs:

- (a) CSDs shall:
 - (i) calculate and apply the cash penalties in accordance with Article 16;
 - (ii) collect from and distribute to their participants the net amount of cash penalties in accordance with Article 17;
 - (iii) manage costs relating to the application of the cash penalties mechanism to such transactions in accordance with Article 18.
- (b) CCPs may allocate to their clearing members the net amount of penalties, credit or debit, received from or paid to the other CSD participants pursuant to point (a). In such cases, CCPs shall establish relevant mechanism in their rules.”



Article 2

Entry into force and application

1. This Regulation shall enter into force on the on the twentieth day following that of its publication in the Official Journal of the European Union.
2. It shall apply from the first business day of the sixth month following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,