

# CSDR Settlement Discipline – Overview

6 May 2020



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# Agenda

This webinar will provide an overview of the CDSR settlement discipline regime and its application to cleared derivatives, including

- Implementation timeline
- Transaction and territorial scope
- Application to cleared derivatives
- Outstanding advocacy issues
- Documentation implications

# Central Securities Depositories Regulation

## Securities settlement

- Dematerialisation of securities
- Speeding up settlement
- Improving settlement discipline
- Reporting internalised settlement

*today's focus...*

## Provision of CSD services

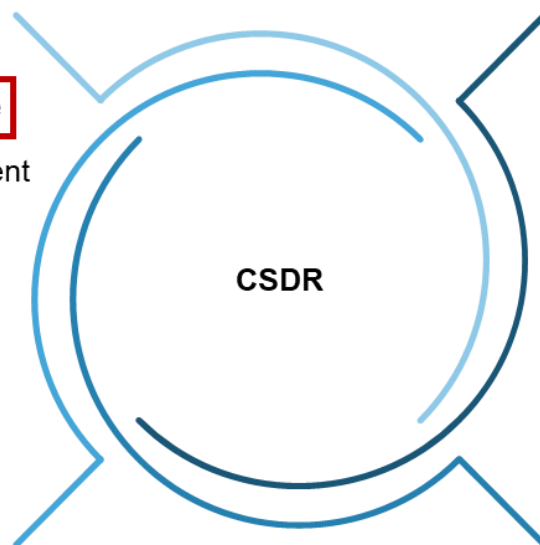
- Ability of CSDs to provide banking services
- Provision of banking services to CSDs

## Authorisation and supervision of CSDs

- Authorisation of CSDs
- Qualification and ongoing requirements for CSDs
- Access to CSDs

## Timing

- Published in OJ in 2014
- First CSDs authorised in 2018
- Settlement discipline requirements expected to apply from **1 February 2021** (delayed from September 2020)



# CDSR Settlement Discipline

## Preventing settlement fails (Article 6)

- EEA trading venues to establish procedures for confirmation of transaction details on the execution date
- MiFID investment firms must take measures to limit the number of settlement fails
  - including written allocation and confirmation arrangements with professional clients
- EEA CSDs to facilitate, promote and incentivise timely settlement of transactions on the intended settlement date (ISD)

## Addressing settlement fails (Article 7)

- EEA CSDs to monitor and report on settlement fail rates to NCAs
- In case of a settlement fail:
  - EEA CSDs will impose cash penalties on the 'failing' CSD participant for each day the settlement instruction fails to settle
  - CSDR introduces a mandatory buy-in procedure will be triggered after an initial 'extension period' (with some exceptions)
- EEA CSDs, CCPs and trading venues may suspend or censure participants that "consistently and systematically" fail to deliver financial instruments on the ISD

Timing: settlement discipline requirements expected to apply from 1 February 2021 (delayed from September 2020)



# CSDR Settlement Discipline Scope (1)

## Financial Instrument Scope

### Financial instruments in scope (general)

- In general, the settlement discipline requirements under Articles 6 and 7 CSDR apply to transactions in
  - transferable securities
  - money-market instruments
  - units in collective investment schemes
  - emission allowances
- that are to be settled via an EEA CSD.

### Financial instruments in scope (Art 7 only)

- Cash penalties and buy-in requirements limited to instruments referred to above that are:
  - admitted to trading or traded on an EEA trading venue or
  - cleared by an EEA CCP.

### Territorial scope considerations

- Territorial scope linked to where settlement takes place
- Means there is extra-territorial impact for non-EEA firms entering into transactions where settlement happens via an EEA CSD (e.g. Euroclear, Clearstream)
- Plus, participants in EEA CSDs, CCPs and trading venues will be impacted by rulebook changes



# CSDR Settlement Discipline Scope (2)

## Transaction Scope and Carve Outs

### Transaction scope

- The term ‘transaction’ is not defined in CSDR
- But the RTS on settlement discipline provide examples, including
  - collateral management operations
  - securities financing transactions (subject to a carve-out from the buy-in regime where ISD of the second leg is set within 30 days of the first leg)
- Points towards broad interpretation (subject to ESMA guidance)

### Carve outs from cash penalties and buy-ins

- Cash penalties and buy-in requirements do not apply
  - to dual-listed shares where the principal trading venue for trading is outside the EEA
  - where insolvency proceedings have been opened against the CSD participant
- Buy-in requirements do not apply to “operations composed of several transactions” where the timeframe is sufficiently short to render the buy-in ineffective (e.g. SFTs referred to above)



# CSDR Settlement Discipline Scope (3)

## Implications for Cleared Derivatives

### Application to cleared derivatives

- Trades in ETDs / other cleared derivatives not themselves in scope as these trades are not “settled” in CSDs
- But cleared derivatives may be impacted where they involve deliveries of in-scope financial instruments – i.e. for
  - physical settlement of derivatives transactions where the underlying is an in-scope financial instrument (e.g. equity options)
  - margin transfers of in-scope financial instruments

### Advocacy issues

- **Note:** outstanding advocacy question about whether margin transfers are out of scope of mandatory buy-in regime
  - ESMA is currently considering a draft Q&A on this point
- Plus, FIA intends to advocate that derivatives should be out of scope more broadly

### When might a “settlement fail” occur?

- Important to distinguish a “settlement fail” from failure to deliver more generally
- Settlement fails will only occur if settlement instructions have been entered into an EEA CSD and then fail to settle
- Note that settlement fails could occur due to lack of securities or cash and that
  - cash penalties apply in either case (i.e. where settlement fail is caused by lack of securities or cash)
  - buy-ins apply to settlement fails caused by failure to deliver securities only



# Cash Penalties



## Cash penalties

### **Deterrent for causing settlement fails**

- EEA CSDs will apply cash penalties on their participants via rulebook changes
- But, if the participant is a CCP, the CCP is required to collect and distribute cash penalties between its clearing members (again, via rulebook changes)

### **Calculation and application of cash penalties**

- Penalties apply for each business day where settlement instruction fails to settle
  - even if settlement instruction put on hold
  - subject to matching of settlement instructions (but penalties backdated if matched after the intended settlement date)
- Penalty rate depends on type of financial instrument

### **Documentation impact**

- No direct regulatory impact on FIA documentation as penalties imposed via CSD and CCP rulebooks
- But CSD participants and clearing members may consider whether to seek contractual rights to pass on cash penalties to clients where the client “caused” the settlement fail



# Mandatory Buy-ins

## Mandatory buy-ins

### Responsibility for buy-in

- Depends on whether the transaction is cleared or executed on venue:
  - CCPs responsible if cleared
  - trading venue members responsible if uncleared, on-venue
  - trading parties responsible if uncleared, OTC

### Buy-in costs, price different and cash compensation

- Failing clearing member, trading venue member or trading party (as applicable) also required to pay:
  - buy-in costs
  - price difference (if buy-in price higher than original transaction price)
  - cash compensation, if buy-in fails or is not possible

### Documentation impact

- EEA CSDs, CCPs and trading venues will need to amend their rulebooks
- Direct impact on FIA documentation as parties in the settlement chain – up to the trading parties – will need to establish contractual arrangements covering buy-in process obligations that are enforceable in all relevant jurisdictions
- Plus consideration of how the CSDR buy-in interacts with existing default and termination etc. provisions in FIA documentation



# Speakers



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