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PROPOSAL

From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
date of receipt:	19 April 2023
To:	Ms Thérèse BLANCHET, Secretary-General of the Council of the European Union
No. Cion doc.:	C(2023) 2484
Subject:	COMMISSION DELEGATED REGULATION (EU) /... on amending the regulatory technical standards laid down in Delegated Regulation (EU) 2018/1229 as regards the penalty mechanism for settlement fails relating to cleared transactions submitted by CCPs for settlement

Delegations will find attached document C(2023) 2484.

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COMMISSION

Brussels, 19.4.2023
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COMMISSION DELEGATED REGULATION (EU) .../...

of 19.4.2023

**on amending the regulatory technical standards laid down in Delegated Regulation (EU)
2018/1229 as regards the penalty mechanism for settlement fails relating to cleared
transactions submitted by CCPs for settlement**

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Regulation (EU) No 909/2014 (CSDR)¹ harmonises the conduct of securities settlement in the Union and the rules governing central securities depositories (CSDs). One of the main objectives of this Regulation is to improve the safety and efficiency of securities settlement, in particular for cross-border transactions, by ensuring that buyers and sellers receive their securities and payment on time and without risks. To achieve this objective, the Regulation harmonises the timing and framework for securities settlement in the Union. In particular, it provides for a set of measures to prevent and address failures in the settlement of securities transactions ('settlement fails'), commonly referred to as settlement discipline measures.

Against this background, CSDR empowers the Commission to adopt, following submission of draft regulatory technical standards by the European Securities and Markets Authority ('ESMA'), and in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010 establishing ESMA², a delegated Regulation specifying further the settlement discipline measures set out in the Regulation. Commission Delegated Regulation (EU) 2018/1229³ on settlement discipline ('RTS on settlement discipline'), specifies the following:

(a) measures to prevent settlement fails, including measures to be taken by financial institutions to limit the number of settlement fails as well as procedures and measures to be put in place by CSDs to facilitate and incentivise timely settlement of securities transactions;

(b) measures to address settlement fails, including the requirements for monitoring and reporting of settlement fails by CSDs; the management by CSDs of cash penalties paid by users causing settlement fails; the details of an appropriate buy-in process following settlement fails; the specific rules and exemptions concerning the buy-in process and the conditions under which a CSD may discontinue providing services to users that cause settlement fails.

The provisions to prevent settlement fails, the monitoring and reporting requirements and the cash penalties of the RTS on settlement discipline entered into application on 1 February 2022.

¹ 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 Directive 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (OJ L 257, 28.8.2014, p. 1).

² 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).

³ 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).

The RTS on settlement discipline details, amongst other things, the processes for the collection and distribution of cash penalties and any other possible proceeds from cash penalties. Article 19 of the RTS on settlement discipline details a specific process for the collection and distribution of penalties relating to cleared transactions by CCPs, in parallel to the general process specified in Article 17 of the same Regulation for the collection and distribution of penalties managed by CSDs.

The objective of the parallel CCP-run process was to specify the application of the penalty mechanism for settlement fails relating to cleared transactions when CCPs are involved, to ensure compliance with Article 7(11) of CSDR, which exempts CCPs from paying penalties in relation to settlement fails of transactions for which they interpose themselves between counterparties.

As part of the preparations for the implementation of cash penalties, both CCPs and CSDs, as well as the banking sector, expressed concerns about the duplicative process and how it could work in practice and indicated that penalties for settlement fails relating to cleared transactions could be fully calculated, applied, collected and distributed by CSDs, from and to all the participants identified in the 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.

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. These parallel arrangements however create unnecessary operational risks and operating costs that a CSD-run cash penalties process would eliminate.

After conducting a public consultation and consulting the Securities and Markets Stakeholder Group ('SMSG') and the European System of Central Banks ('ESCB'), ESMA adopted a report⁴ on 21 November 2022, proposing to remove the separate process established in Article 19 of the RTS on settlement discipline for the collection and distribution of the cash penalties in relation to settlement fails relating to cleared transactions to put the CSDs in charge of the entire process of collection and distribution of penalties according to Articles 16, 17 and 18 of the same regulation.

However, in certain cases such as a late delivery of securities to a CCP on the intended settlement date 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, 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 should be allowed to allocate to their clearing members the remaining net amount of penalties, credit or debit, and should establish an appropriate mechanism in their rules to that effect

Final Report on draft RTS amending Article 19 of Commission Delegated Regulation (EU) 2018/1229 – [ESMA proposes amendment to simplify cash penalties process for cleared transactions under CSDR \(europa.eu\)](#)

To these effects, ESMA proposed an amendment to Article 19 of Commission Delegated Regulation (EU) 2018/1229.

To facilitate the calculation and distribution of the cash penalties related to settlement fails relating to cleared transactions, while at the same time reducing the risks and the cost related to such process, it is desirable that this process on the collection and distribution of cash penalties is conducted by CSDs as suggested in the report from ESMA.

Article 19 of Delegated Regulation (EU) 2018/1229 should therefore be amended accordingly and it seems appropriate for the Commission to endorse the draft RTS as submitted by ESMA.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

ESMA conducted a public consultation on its draft Commission Delegated Regulation between 11 July 2022 and 9 September 2022. ESMA has received a total of 261 responses, out of which 16 came from institutions, trade associations and corporates from the financial sector, covering CSDs, CCPs and their clients. All other responses were sent by individuals on the unrelated topic of mandatory buy-ins. ESMA has assessed the feedback received and made modifications to its original proposals where relevant.

ESMA has consulted the Securities and Markets Stakeholder Group ('SMSG') and has conducted a high-level analysis of the costs and benefits. ESMA has also cooperated closely with the members of the European System of Central Banks ('ESCB').

More specifically, ESMA noted that the main benefit of this proposal would be the relief for market participants through lowering operational risks and the costs of the collection and distribution process by simplifying the process. The main costs would stem from the need for market participants, mostly CSDs and CCPs, to adapt their systems to the new process.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The Commission Delegated Regulation removes the separate process established in Article 19 of the RTS on settlement discipline for the collection and distribution of the cash penalties in relation to settlement fails relating to cleared transactions to put the CSDs in charge of the entire process of collection and distribution of penalties according to Articles 16, 17 and 18 of the same regulation. The Commission Delegated Regulation also specifies that in case of imbalanced positions in respect of cleared transactions the CCPs may allocate the remaining penalties' amount, credit or debit, to their clearing members and should establish relevant mechanism in their rules to that effect.

COMMISSION DELEGATED REGULATION (EU) .../...

of 19.4.2023

on amending the regulatory technical standards laid down in Delegated Regulation (EU) 2018/1229 as regards the penalty mechanism for settlement fails relating to cleared transactions submitted by CCPs for settlement

(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 236/2012⁵, and in particular Article 7(15), third subparagraph, thereof,

Whereas:

- (1) Pursuant to Article 7(11) of Regulation (EU) 909/2014, the cash penalties regime is not to apply to failing participants which are CCPs.
- (2) Article 19 of Commission Delegated Regulation (EU) 2018/1229⁶ as currently applicable provides for a specific mechanism on the collection and distribution by CCPs of cash penalties ('penalty mechanism') 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.
- (3) However, due to the multiplicity of parties involved, the application of the penalty mechanism by CCPs adds operational risks, technical complexities and costs to the process of collecting and distributing cash penalties for settlement fails relating to cleared transactions. 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 settlement instructions submitted by CCPs, 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.

⁵ OJ L 257, 28.8.2014, p. 1

⁶ 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).

- (4) Pursuant to Article 2(19) of Regulation (EU) No 909/2014, any institution, central counterparty, settlement agent, clearing house, system operator or clearing member of a CCP may qualify as a participant.
- (5) To facilitate the calculation, collection and distribution of the cash penalties for fails of settlement instructions relating to cleared transactions submitted by CCPs, while at the same time reducing the risks and the cost related to such process, CSDs should calculate, collect from and distribute to their relevant participants, pursuant to Articles 16, 17 and 18 of Delegated Regulation (EU) 2018/1229, the cash penalties relating to settlement instructions submitted by CCPs for cleared transactions.
- (6) Where CCPs interpose themselves between counterparties, the net amount of penalties that CSDs have to collect and distribute in relation to settlement instructions submitted by a CCP would normally amount to zero since the settlement instructions submitted by the CCP represent both legs of the cleared transactions. However, in certain cases such as a late delivery of securities to a CCP on the intended settlement date 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, 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 should be allowed to allocate to their clearing members the remaining net amount of penalties, credit or debit. CCPs should establish an appropriate mechanism in their rules to that effect.
- (7) Delegated Regulation (EU) 2018/1229 should therefore be amended accordingly.
- (8) To ensure that the calculation of penalties for settlement fails that occur before the date of application of this Regulation is not retroactively affected, it is appropriate to include transitional provisions.
- (9) To enable CCPs and CSDs to implement the necessary technological adaptations in view of ensuring compliance with the amended penalty mechanism, it is appropriate to defer the application of this Regulation.
- (10) This Regulation is based on the draft regulatory technical standards developed in close cooperation with the members of the European System of Central Banks and submitted to the Commission by the European Securities and Markets Authority.

- (11) The European Securities and Markets Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the advice of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council⁷,

HAS ADOPTED THIS REGULATION:

Article 1

Amendment to Delegated Regulation (EU) 2018/1229

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

‘Article 19

Penalty mechanism for settlement fails relating to cleared transactions submitted by CCPs for settlement

With respect to settlement fails relating to cleared transactions submitted by CCPs for settlement, CSDs shall apply Articles 16, 17 and 18.

CCPs may allocate to their clearing members any remaining net amount of penalties, credit or debit, paid pursuant to Article 16 and distributed pursuant to Article 17(2).

CCPs shall establish an appropriate mechanism in their rules to that effect.’

⁷

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).

Article 2

Transitional provision

Article 19 of Delegated Regulation (EU) 2018/1229 as applicable on ... [OP please insert the date= date of application of this amending Regulation minus one day] shall continue to apply to settlement fails that occurred before ...[OP please insert the date = the date of application of this amending Regulation].

Article 3

Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply from ... [OP please insert the date: first business day after 12 months from the date of entry into force of this Regulation].

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

Done at Brussels, 19.4.2023

For the Commission
The President
Ursula VON DER LEYEN