COMMISSION DELEGATED REGULATION (EU) …/...

of 8.5.2020


(Text with EEA relevance)
EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Regulation (EU) No 909/2014 ("the Regulation") harmonises the conduct of securities settlement in the Union and the rules governing central securities depositories (CSDs). One of the main objectives of the 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 money 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, the Regulation 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 ESMA, a delegated Regulation specifying further the settlement discipline measures set out in the Regulation. Commission Delegated Regulation (EU) 2018/1229 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 their 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 its services to users that cause settlement fails.


In accordance with Article 10(1) of Regulation (EU) No 1095/2010, the Commission shall decide within three months of receipt of the draft regulatory standards whether to endorse the draft submitted. The Commission may also endorse those draft regulatory standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in that Article.

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The new settlement discipline regime under the Regulation will affect a wide range of market participants (CSDs, CCPs, trading venues, investment firms, credit institutions) and authorities, and will require significant IT system changes, market testing and adjustments to legal arrangements between the parties concerned. In this regard, according to Article 20 of Commission Delegated Regulation (EU) 2018/1229, “CSDs that use a common settlement infrastructure, including where some of their services or activities have been outsourced as referred to in Article 30(5) of Regulation (EU) No 909/2014, shall jointly establish the penalty mechanism referred to in Article 7(2) of Regulation (EU) No 909/2014 and jointly manage the modalities for the calculation, application, collection and distribution of cash penalties in accordance with this Regulation.” In accordance with this requirement, CSDs which use TARGET2 - Securities (T2S) have mandated the Eurosystem to build a common T2S penalty mechanism. The T2S penalty mechanism will provide a single cash penalty calculation engine and reference data source, as well as common reporting and operational tools for all T2S CSDs.

The T2S penalty mechanism is a major development in the T2S landscape to support T2S CSDs in their compliance with the settlement discipline regime, providing a single source for the calculation and reporting of cash penalties. Substantial implementation efforts have to be deployed both at the level of the Eurosystem and of the CSDs, including for testing activities, in order to accommodate the testing requirements commanded by the implementation of a major functionality within a limited timeframe. Market participants across the value chain (e.g. clients of CSD participants) will also need to mobilise substantial time and resources to adapt to the new cash penalty framework.

The T2S penalty mechanism is expected to go into operation during the weekend of 21-22 November 2020. As indicated in ESMA’s report, according to information provided by the ECB, an earlier implementation date would put a high risk on the quality of the software delivered in production due to shorter development and/or testing times and is not deemed manageable. Likewise, market readiness is also under tight constraints with the current implementation timeline. Finally, it would also require a change in the SWIFT ISO standards release yearly schedule which is agreed among stakeholders worldwide (the annual release for 2020 will be on 21-22 November). Although the majority of EU CSDs are part of T2S, other CSDs may face similar constraints, as well as the CSD participants that will be subject to the cash penalty regime.

Another important change brought about by the settlement discipline regime is the mandatory buy-in process. The buy-in process requires significant changes to current market practices and contractual arrangements, involving a wide range of market participants (CSDs, CCPs, trading venues, investment firms, credit institutions), and major IT developments, including new or updated ISO messages.

Additionally, CSDs have to change their systems and procedures and have to put in place new functionalities in order to facilitate and incentivise settlement on the intended settlement date, as well as in order to monitor and address settlement fails.

Finally, CSDs have to send monthly and annual settlement fails reports to the competent and relevant authorities, which in turn will be sent by competent authorities to ESMA. For this, CSDs, competent authorities and ESMA have to put in place IT systems for the submission and the reception of the reports, which will be based on ISO 20022 compliant messages.

Taking into account the additional time needed due to the aforementioned developments, which could not be envisaged at the time of adoption of Commission Delegated Regulation (EU) 2018/1229, a delay in the entry into force of the relevant rules is required in order to ensure a date of entry into force which allows the appropriate IT adjustments to be made in a
timely manner. It seems therefore appropriate for the Commission to endorse the draft RTS as submitted by ESMA.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

On 4 February 2020, ESMA adopted a report proposing a delay in the entry into force of Commission Delegated Regulation (EU) 2018/1229. Given that the proposed amendment is limited in scope and is targeted to address specific issues raised by the concerned market participants, ESMA did not conduct any open public consultation in accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1095/2010 ("the Authority shall conduct open public consultations on draft regulatory technical standards and shall 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 regulatory technical standards concerned"). However, ESMA requested the advice of the Securities and Markets Stakeholder Group and conducted a high-level analysis of the costs and benefits. More specifically, in its analysis ESMA noted that the benefits of this proposal would be: (a) provision of sufficient time for market participants and authorities to make the necessary IT system changes, to develop and update the relevant ISO messages and to put in place the legal arrangements needed for the implementation of the settlement discipline regime under Commission Delegated Regulation (EU) 2018/1229; (b) avoidance of the risk of non-compliance with legal requirements due to technical impossibilities; and (c) legal certainty and transparency for the market. As to the costs, ESMA concluded that the expected impact of the proposed delay would represent a relief for market participants and authorities and that no additional costs are envisaged. Therefore, ESMA reached the conclusion that the benefits of its proposal outweigh the costs. ESMA also cooperated closely with the members of the European System of Central Banks. Stakeholders have also contacted the Commission in support of a delay in the entry into force of Commission Delegated Regulation (EU) 2018/1229.

3. LEGAL ELEMENTS OF THE DELEGATED ACT


Taking into account that for 2020 ISO messages will be released on 21-22 November 2020, and that the T2S penalty mechanism operated by the ECB will go into operation on the same dates, as well as the need to have a reasonable buffer to cover for potential operational complexities after the go live as well as to avoid an overlap with operational issues at the turn of the year, it seems appropriate to set the date for the entry into force of Commission Delegated Regulation (EU) 2018/1229 at 1 February 2021.

The proposed Commission Delegated Regulation should enter into force three days following the day of its publication in the Official Journal, to ensure that it enters into force before Commission Delegated Regulation (EU) 2018/1229 does.
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(Text with EEA relevance)

THE EUROPEAN COMMISSION,

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


Whereas:

(1) Commission Delegated Regulation (EU) 2018/1229 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 buy-in process.

(2) Stakeholders including CSDs, CCPs, trading venues, investment firms and credit institutions, have indicated that due to new developments, such as the envisaged implementation on 21-22 November 2020 of the penalty mechanism jointly established by CSDs that use a common settlement infrastructure, more time is needed to adapt to the measures specified in Delegated Regulation (EU) 2018/1229. Affected stakeholders have also indicated that more time is needed for the necessary IT system changes, for the development and update of ISO messages, and for market testing and changes to the contractual arrangements between the parties concerned. The European Securities and Markets Authority (ESMA) has considered it appropriate to provide stakeholders with more time to adapt to those measures. The entry into force of Delegated Regulation (EU) 2018/1229 should therefore be deferred.

(3) Delegated Regulation (EU) 2018/1229 should therefore be amended accordingly.

(4) This Regulation is based on the draft regulatory technical standards submitted to the Commission by ESMA.

(5) The scope and expected impact of this amendment is limited as it concerns only a brief delay in the date upon which the new settlement discipline regime will be applicable and market participants have already provided their input. ESMA has not conducted any open public consultations. ESMA has nevertheless conducted an analysis of the

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potential related costs and benefits and has 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 Council\(^6\). In developing the draft regulatory technical standards, ESMA has also cooperated with the members of the European System of Central Banks. Stakeholders have also contacted the Commission in support of a delay in the entry into force of Commission Delegated Regulation (EU) 2018/1229,

HAS ADOPTED THIS REGULATION:

**Article 1**

**Amendment to Delegated Regulation (EU) 2018/1229**

Article 42 of Delegated Regulation (EU) 2018/1229 is replaced by the following:

“**Article 42**

**Entry into force**

This Regulation shall enter into force on 1 February 2021.”

**Article 2**

**Entry into force and application**

This Regulation shall enter into force on the third day 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, 8.5.2020

*For the Commission*

*The President*

*Ursula VON DER LEYEN*

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