

CSDR (CENTRAL SECURITIES DEPOSITORY REGULATION)



Central Securities Depositories (CSDs) are Financial Market Infrastructures (FMIs) alongside Trading Venues, Central Counterparties (CCPs), Trade Repositories and Payment Systems. Like CCPs they contribute to a large degree in maintaining the financial stability.

In October 2010, the Financial Stability Board called for more robust FMIs and for a reinforcement of the existing standards this resulting in the publication by CPSS – IOSCO, in 2012, of the *Principles for financial market infrastructures* (PFMI). The PFMI recalled that “a central securities depository provides securities accounts, central safekeeping services, and asset services, which may include the administration of corporate actions and redemptions, and plays an important role in helping to ensure the integrity of securities issues (that is, ensure that securities are not accidentally or fraudulently created or destroyed or their details changed)”. The conclusion made is that “CSDs play a critical role in the protection of securities and help ensure the integrity of securities transactions”.

CSDR, following MIFID2/MIFIR (covering Trading Venues) and EMIR (focused on CCPs), addresses the CSD’s topic in Europe by giving the latter a regulatory framework in which they can exercise their function meanwhile requiring several measures to improve the settlement and to reinforce the investor protection.

CSDR is built on four main pillars:

1. **INFRASTRUCTURE**, by laying down a unified and harmonised framework for all European CSDs
 - Defining a CSD, its role and its responsibilities
 - Establishing a set of common requirements for CSDs operating securities settlement systems
 - Freeing the choice of an issuer CSD for issuers
 - Requiring CSDs to have a recovery plan
2. **STRENGTHENING THE INVESTOR PROTECTION**
 - Dematerialization and immobilisation of securities, book-entry form for transferable securities
 - Segregation of investors’ assets
3. **IMPROVEMENT OF THE SETTLEMENT**
 - Reduction of the settlement cycle
 - Reinforcement of the obligation to settle transactions in transferable securities, money-market instruments, units in collective investment undertakings or emission allowances on the date agreed between the parties (also called: ISD for Intended Settlement Date)
 - Imposition of a settlement disciplines regime: set of several measures aiming to prevent and address settlement fails and thus have a transaction be fully settled on ISD
4. **TRANSPARENCY**
 - Setting obligations of reporting to national competent authorities and ESMA
 - Identification of the issuing entities via the use of LEI (Legal Entity Identifier)

1. Overview

- Key aspects of the Regulation

- Definition of a CSD (effective from 17/09/2014)

INFRASTRUCTURE

CORE SERVICES

3 core services have been retained:

- Initial recording of securities in a book-entry system (**‘notary service’**);
- Providing and maintaining securities accounts at the top tier level (**‘central maintenance service’**);
- Operating a securities settlement system (**‘settlement service’**).

DEFINITION OF A CSD

A CSD is legal person that operates a securities settlement system and provides at least one other core service.

ISSUER / INVESTOR CSD – INTERNATIONAL CSD

In application of the CSDR's definition of a CSD, international CSDs (also called ICSDs), namely EOC Bank and Clearstream Banking Luxembourg, are CSDs since they operate a SSS and provide the central maintenance service.

If the level 1 of CSDR refers only to "CSD", the level 2, made of delegated regulations, brings some clarification by distinguishing between Issuer CSD and Investor CSD. According to the delegated act (2017/392):

- **'issuer CSD'** means a CSD which provides the notary service or the central maintenance service in relation to a securities issue
- **'investor CSD'** means a CSD that either is a participant in the securities settlement system operated by another CSD or that uses a third party or an intermediary that is a participant in the securities settlement system operated by another CSD in relation to a securities issue

- General framework for CSDs (effective from 01/12/2016)

The regulation details the requirements a CSD shall comply with. They cover organisational and operational procedures as well as prudential requirements giving the business framework for CSD activities (designation of competent authorities, CSD licensing, passport of CSDs, third countries CSDs, organizational and transparency rules and CSD governance, risk mitigation, integrity of issuance, ...).

CSD'S AGREEMENT

INFRASTRUCTURE

CSDR requires all CSDs located within the Union to obtain their agreement under CSDR (no grandfather clause for already operational CSDs). The process to obtain authorization may be long and complex depending on the size of the CSD. It is managed with the Competent authority that transmits all information to any other relevant authorities (Central Bank, other Member States authorities if needed). However, within six months from the submission of a complete application, the competent authority informs the applicant CSD whether the authorisation has been granted or not.

The register of granted CSDs is available on the ESMA website (cf. point 2 below).

INTEGRITY OF THE ISSUANCE

PROTECTION

CSD shall have appropriate rules and procedures (accounting practices, controls...) to ensure the integrity of securities issues. Daily reconciliation measures, including cooperation with potential other entities involved in the reconciliation process (issuer, registrars, issuance agents, transfer agents, common depositories, other CSDs...) shall permit to verify that the number of securities making up a securities issue or part of it is equal to the sum of securities recorded on the securities accounts of the participants. Securities overdrafts, debit balances or securities creation shall not be allowed in a securities settlement system operated by a CSD.

SEGREGATION

PROTECTION

TRANSPARENCY

CSD shall keep records and accounts to segregate in the accounts with the CSD, the securities of a participant from those of any other participant and from the CSD's own assets. It shall also enable any participant to segregate its securities from those of its clients and offer the choice of having "omnibus account structures" or "individual client segregation". Participant of the CSD shall offer its clients at least the choice between these two structures at CSD level and inform them of the costs and risks associated with each option. The individual segregation is an obligation for citizens, residents and legal persons established in a Member State where this account structure is required.

A CSD shall not use securities that do not belong to it provided unless it has the participant's prior express consent.

- The "T+2" settlement cycle (mainly effective as from 6 October 2014)

SETTLEMENT

CSDR institutes a settlement/delivery cycle taking place a maximum of two days after the trading date (T). It applies to transactions in transferable securities when executed on a Trading Venue (Regulated Market, MTF or OTF as defined in MIFID2/MIFIR). Harmonisation was required to be effective by 1st January 2015 with specific cases of postponement to 2016 or six months before a T2S migration. It must be noted that most of the European countries decided to anticipate the move. Thus the "big bang" took place on the 6th of October 2014 for most of them. If CSDR opens the door to a potential T+1 or even T settlement cycle, all the markets went to a "T+2" cycle.

Over The Counter (OTC) transactions in transferable securities are de facto not concerned by the “T+2” requirement. However, they remain submitted to the obligation to settle on the agreed Intended Settlement Date (same as for transactions in money-market instruments, units in collective investment undertakings and emission allowances).

- Dematerialization and immobilisation of securities, (as of 1st January 2023 for new issuance and 1st January 2025 for all securities)

PROTECTION

SETTLEMENT

CSDR imposes the book entry form for transferable securities admitted to trading or traded

on a trading venue where the issuer is established in the Union. The objective of this requirement is two folds: firstly, to increase the efficiency of the settlement and secondly to ensure the integrity of a securities issue.

With regards to the initial book-entry recording, the regulation does not impose any form leaving the choice between immobilisation (*the act of concentrating the location of physical securities in a CSD in a way that enables subsequent transfers to be made by book entry*) or immediate dematerialisation (*where financial instruments exist only as book entry records*). It only requires the initial book-entry to be recorded by a CSD once transactions in such securities are executed on trading venues or provided as collateral. Initial recording of securities in a book-entry system also called ‘notary service’ is one of the core services that defines a CSD.

To be noted: the book-entry form is mandatory for new issuances as well as for transferable securities already issued. Thus, CSDR has defined two dates for the start of the obligation: 1st January 2023 for the former and 1st January 2025 for all.

- Settlement disciplines regime (as of 14th September 2020)

SETTLEMENT

CSDR requires participant to settle transactions in transferable securities, money-market instruments, units in collective investment undertakings and emission allowances on the intended settlement date.

In addition, and for transactions on financial instruments which are admitted to trading or traded on a trading venue or cleared by a CCP, CSDR requires CSDs to have a settlement disciplines regime in place to prevent and address settlement fails. Its coverage is wide and extends to almost all the post-trade areas. Starting at the point in time where the transaction is confirmed, it continues with the application of penalties for each failing day and ends up with a buy-in process. It might be noted that CSDs are required to provide their participants with functionalities facilitating the settlement.

CONFIRMATION / ALLOCATION

With a delay for settlement down to 2 days, there is a need to ensure at the earliest stage that all the necessary settlement information has been exchanged. This is the rationale for this requirement applied to the parties of the transaction. Investment firms will require their professional clients to provide them in the written allocation / written confirmation with any information needed to ease the settlement (included the identification of the accounts to be used). Moreover, it must be received on trade day (T) or under certain condition before T+1 noon.

PENALTIES

A matched settlement instruction that is not fully settled on ISD shall be penalized irrespective of the reason of the non-settlement (lack of securities, lack of cash, instruction put on hold, instruction matched after the ISD,...). The penalty is applied for each day the instruction fails to settle. It is calculated at the level of the instruction, on ad valorem basis (the rate depends on the type of the financial instrument or on the currency) and using a reference price that should be the same whatever the CSD (the calculation shall be identical for all EU CSDs). The penalty paid by the failing participant to the CSD will be given back the counterparty of the former. Thus, in case of a chain of settlements, it will remain neutral for participants in the middle.

BUY-INS

CSDR considers that failing settlements can't remain endlessly as such, even if penalised. Therefore, CSDR institutes a mandatory buy-in process aiming to close the outstanding settlement. The buy-in shall be triggered by the buyer against the seller (meaning at the transaction level rather than the settlement level). It shall happen 4 or 7 days after ISD but up to 15 days for transactions executed on a SME Growth market (as defined in MIFID2/MIFIR). The buyer will appoint a buy-in agent to buy the missing instruments. The costs related to this purchase will be charged to the defaulter. A cash compensation procedure may be used in case the buy-in agent didn't succeed.

If the buy-in only applies when the reason of the fail is linked to the securities, it covers all failing settlements (including OTC ones) and thus goes beyond the current buy-in process triggered by CCPs against failing clearing members.

- Reporting to competent authorities / ESMA

TRANSPARENCY

FOR CSDS (AS OF THEIR AGREEMENT)

CSDs shall publish on their website information on settlement fails (global volumes, volumes of fails to deliver and of fails to pay, rates of settlement fails, ..., measures to improve settlement efficiency if needed).

In addition, they are required to provide the competent authorities with more detailed information on settlement fails. Moreover, the reporting shall include the “top 10” participants with highest rates of settlement fails during the covered period (LEI, figures in value and in volume, rates of settlement fails)

FOR CUSTODIANS: REPORTING ON INTERNALISED SETTLEMENTS (FIRST QUARTERLY REPORT DEADLINE: 12 JULY 2019)

CSDR defines “settlement internaliser” as any institution which executes transfer orders on behalf of clients or on its own account other than through a securities settlement system.

Settlement internalisers shall report to the competent authorities of their place of establishment on a quarterly basis the aggregated volume and value of all securities transactions that they settle outside securities settlement systems. This report shall be submitted within 10 working days from the end of the quarter to be reported. Competent authorities transmit the information to ESMA and inform ESMA of any potential risk resulting from that settlement activity.

The first quarterly report will be reported by 2019, July the 12th and will cover activity from April to June 2019.

- **Other aspects:**

- Choice of the issuer CSD (as of the CSD agreement)

INFRASTRUCTURE

CSDR allows issuers to arrange for its securities admitted to trading on regulated markets or MTFs or traded on trading venues to be recorded in any CSD established in any Member State. The corporate or similar law of the Member State under which the securities are constituted shall continue to apply.

- Banking license / purpose bank (as of the CSD agreement)

INFRASTRUCTURE

CSDR defines separation between CSD and Banking activities.

A CSD shall not itself provide any banking-type ancillary services unless it has obtained an additional authorisation to provide such services in a limited scope of activities linked to settlement.

It can be authorised to provide such service if it is granted as “credit institution”. The banking license can be used only for a limited scope of activities linked with settlement business. This implies specific capital surcharge that reflects the risks, including credit and liquidity risks. The CSD shall monthly and annually report to the competent authority on the extent and management of intra-day liquidity risk. Furthermore, an adequate recovery plan shall be submitted to competent authority to ensure continuity of its critical operations in case of situations where liquidity or credit risk occurs as a result of provision of these banking services.

It can also designate a credit institution to provide these services. The credit institution shall strictly segregate these activities in a specific legal entity being a “limited purposed bank” that will have to send the same kinds of report to the competent authority and submit appropriate recovery plan.

- Outsourcing

INFRASTRUCTURE

A CSD can outsource services or activities to a third party but remains fully responsible.

It must comply with a list of conditions (no delegation of its responsibility, non-alteration of its relationship and obligations to its participants or issuers, no depriving of systems and controls to manage risks, cooperation of the provider with competent authorities, ...).

T2S is an example of Securities Settlement System outsourcing.

- First level of finality

SETTLEMENT

PROTECTION

A CSD shall ensure that the securities settlement system it operates offers adequate protection to participants by ensuring that each securities settlement system it operates defines the moments of entry and of irrevocability of transfer orders. It shall disclose the rules governing the finality of transfers of securities and cash in a securities settlement system.

- CSD links / interoperability (18th September 2019)

INFRASTRUCTURE

A CSD has the right to become a participant of another CSD and set up a standard link with that CSD. The request can be rejected for risk consideration. In that case the demander may complain to the competent authority of CSD having refused access.

Technical regulatory standards specify the risks to be taken into account.

- Passport (as of CSD is agreed)

INFRASTRUCTURE

An authorised CSD may provide services covered by this authorisation within the territory of the Union provided it has communicated to the competent authority of the home Member State the list of Member State in which it intends to operate, the services it wants to provide, the currencies it intends to process as well as the organisational structure in case of branch.

- Third country CSDs

INFRASTRUCTURE

An authorised CSD may maintain or establish link with third-country CSD. Third-country CSDs may also provide CSD services within the Union. This availability is subject to effective authorisation, supervision and oversight, ensuring full compliance with the prudential requirements applicable in that third country.

Cooperation arrangements between ESMA and the responsible authorities in the third country should be established.

- **Progress update and way forward:**

- CSDs' agreement under CSDR

CSDs' agreement process is going on. Few of them have already been granted. Euroclear and Clearstream should be granted in the first semester of 2019.

- Settlement disciplines regime

The delegated regulation dedicated to settlement disciplines has been published in the Official Journal of the EU on the 13th of September 2018, thus confirming two ESMA's proposals (buy-ins to be triggered by the trading parties and a 24 months delay allowed for the implementation) and triggering the countdown. Beyond that, the text doesn't remove uncertainties on the way such new settlement disciplines regime should work.

Exchanges between ESMA and professional associations are still ongoing to clarify the remaining open points. Work is also undertaken at the level of the ECB due to TARGET 2 Securities (T2S) which processes the settlement for numerous EU CSDs. Indeed, T2S will develop a mechanism to calculate the penalties for T2S flows. Moreover it should be designed to welcome also non T2S failing settlements for calculation.

With regards to buy-in, European trade associations (AFME, ICMA, ...) have been required by ESMA to provide it with proposals to cover the points opened by the former. Thematic are the workflow especially in case of chains of settlements, the mean to avoid redundant buy-ins, the scope of transactions concerned, ...

Finally, one must cite the current work lead by SWIFT on the new messages needed to support the settlement disciplines regime. For penalties, they shall be part of the 2019's Change Release.

In the meantime, ESMA is expected to issue guidelines and Q&A which constitute the "level 3" texts.

- Internal settlements' reporting

The first reporting will be processed by custodians by 2019, July the 12th for the April to June 2019 settlement activities. Formats are available. Pending questions should be matter of a ESMA Q&A document waited for January 2019. A period for testing files exchange is foreseen for February/March 2019 with no certainty on the dates. The initial workflow to report (to ESMA via local authorities) is currently matter of discussion and could change (directly to ESMA).

2. Reference law(s) and effective date



[European Parliament - Presentation](#) [European Parliament - Procedure File](#)

[Level 1 regulation](#) of 23 July 2014

[Level 2 acts \(except Settlement Disciplines Regime\)](#) of 11 November 2016

[Level 2 acts \(Settlement Disciplines Regime\)](#) of 25 May 2018 with a compliance date on 13 Sep 2020

[Register of CSDs accredited under CSDR](#)

[Q&A by ESMA](#)

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