

## 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 1<sup>st</sup> 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 6<sup>th</sup> 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 1<sup>st</sup> January 2023 for new issuance and 1<sup>st</sup> 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: 1<sup>st</sup> January 2023 for the former and 1<sup>st</sup> January 2025 for all.

- Settlement disciplines regime (as of February 1<sup>st</sup>, 2021)

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)<sup>(\*)</sup>

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 covers activity from April to June 2019.

*(\*) The date of July the 12<sup>th</sup> is this of the text but may have depended on the capacity of National Competent Authority to receive the reports and transmit them to ESMA. Situations have differed from one country to other.*

- **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 (18<sup>th</sup> 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:**

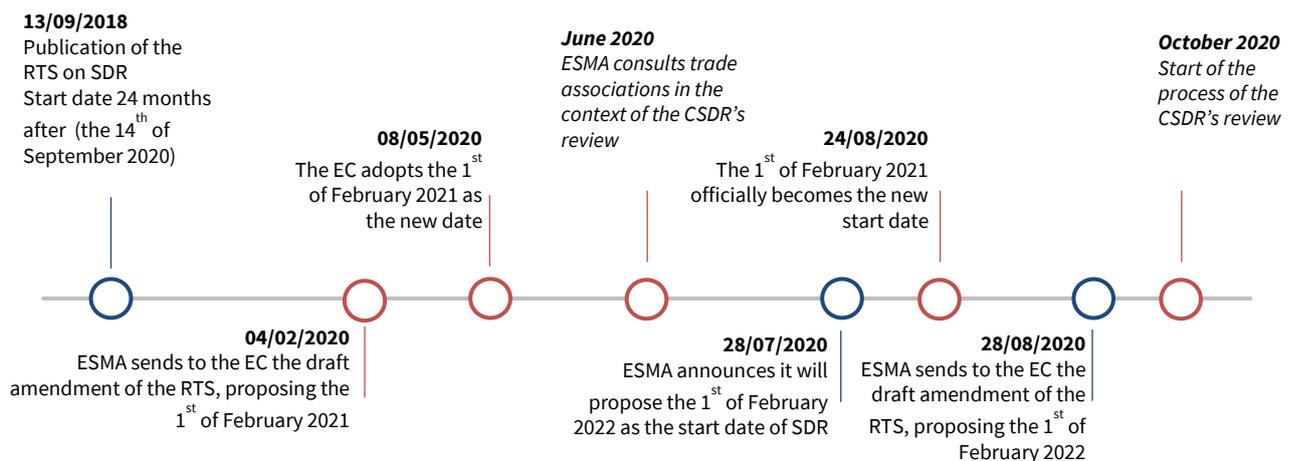
- CSDs' agreement under CSDR

CSDs' agreement process is going on. Not all CSDs have been granted a new agreement yet. The list of agreed CSDs is available on the ESMA's website (see below).

- Settlement disciplines regime

Since the 24<sup>th</sup> of August 2020, the 1<sup>st</sup> February 2021 is now officially the new start date. In the meantime ESMA has issued on the 28<sup>th</sup> of August 2020 following the request of the EC a new amendment of the delegated regulation 2018/1229 where they propose the 1<sup>st</sup> of February 2022.

Main dates:



Such postponement may be the result of several letters sent by trade associations to ESMA and the Commission asking for a postponement of the penalties that will allow the industry to be operationally and technically ready and for a put on hold of the buy-ins process. With regards to the latter, the proposal is to assess the impact of the new penalty regime on the settlement efficiency before any go live of the buy-ins requirement and conduct an in-depth analysis of the mandatory buy-ins impacts. Detailed analysis made by different working groups have shown the complexity, difficulty and negative impacts this measure would have on the market. No answer has been provided so far.

Based on the outcome of the T2S CSDR TF, the European association of CSDs (ECSDA) has established its own framework. The aim is to ensure an harmonized application of CSDR (and firstly on penalties) among CSDs (i.e. beyond T2S) thanks to a single rulebook. The document is updated regularly. EACH (European association of CCPs) has also issued its Framework.

In the meantime, the EC is about to start the process of the CSDR's review and therefore ESMA has issued 3 surveys wanting to get the feedback of some associations.

#### CONFIRMATION / ALLOCATION

ESMA's guidelines have been published.

#### PENALTIES

There are still some last open points. However it is now time for participants and their clients to clean up (to handle outstanding settlements) and to analyse the reasons for current fails in order to improve the situation and avoid too many fails as of the start of the new regime.

According to CSDR penalties related to a settlement with a CCP shall be calculated by the CSD but collected and distributed by the CCP itself. The European association of CCPs (EACH) has advocated for a delegation of the collection / distribution to the CSDs. One waits for ESMA's answer.

Incidentally, the collection of penalties by a CSD is unlikely to be harmonized among CSDs.

Finally one of the main open points relates to the absence of a single golden source gathering all the information required for the application of the settlement disciplines regime.

#### BUY-INS

Among the topics analysed by the associations one can mention:

- The operational workstream of a buy-in
- The scope of transactions for which a buy-in could be triggered
- The avoidance of multiple buy-ins for a single lack of securities and the related topics (the recognition by ESMA of the "pass-on" mechanism, the latter with a CCP is in the loop, chains of transactions with different intended settlement dates, ...)
- The harmonization of the buy-in process among CCPs
- Specific cases like transactions on rights, open Repos, ...
- Impact on contractual arrangements
- A framework of Platform for Management of Buy-Ins

The pass-on mechanism and the definition of a buy-in agent are main ones.

AFME and ICMA have proposed a number of Q&A to ESMA. Few have been agreed and incorporated in their Q&A document.

#### MESSAGES

One must also cite the current work led by SWIFT on the new messages needed to support the settlement disciplines regime (penalty and buy-in).

For penalties, they have been part of the 2019's Change Release :

- a dedicated message (semt.044) originally designed by T2S will be used in the 2022 norm to circulate the daily and the monthly reports of penalties
- In parallel the MT537 and the MT548 have been modified to include the same information; to be noted the MT548 will be available only for the daily report and might not be proposed by all the CSDs.

For buy-ins:

- an adaptation of the MT530 is foreseen in order to transmit the information related to the execution of a buy-in along the custody chain (from the buyer to the CSD).

START DATE – GO LIVE

For the time being, the go live date is the 1<sup>st</sup> of February 2021.

- Internal settlements' reporting

Live.

- Industry's outcome

The French association AFTI has published the first version of its CSDR Guide (in French and in English) to help participants to be compliant with the CSDR requirements.

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## 2. Reference law(s) and effective date

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[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](#)

[ESMA guidelines on allocation / confirmation](#)



**SGSS/CAO/REG** contact : Pierre COLLADON – Sylvie BONDUELLE