Proposed amendments to the Central Securities Depositories Regulation. International Bulletin, June 2022.

The revision of the Central Securities Depositories Regulation (CSDR) represents an essential step in the Capital Markets Union (CMU) Action Plan, the main objective of which is to introduce greater efficiency in the field of post-trading in the European Union (EU), and it also addresses points for improvement that have been identified relating to supervisory convergence as it applies to CSDs. The prior analyses carried out had indicated the need to amend the CSDR to eliminate disproportionate costs and compliance burdens and to simplify the rules regulating CSDs without putting financial stability at risk.
Specifically, the Impact Assessment carried out by the Commission had proposed alternatives to address the issues identified, which are listed below, together with the finally preferred policy options:

1. Passporting requirements: simplify the CSDR passporting process in order to minimise barriers to cross-border settlement and reduce the administrative burden and compliance costs.
2. Coordination and cooperation between authorities: enhance cooperation between national supervisors by establishing colleges of supervisors as the most balanced option.
3. Requirements for the provision of banking services related to settlement in foreign currencies: facilitate CSDs' access to banking-type ancillary services by allowing CSDs with a banking licence to offer such services to other CSDs and reviewing the thresholds below which CSDs may use a commercial bank.
4. Requirements for settlement discipline: clarification of several elements related to settlement discipline.
5. Information on the activities of third-country CSDs in the EU: introduce an end date for the grandfathering clause for both EU and third-country CSDs and a notification requirement for third-country CSDs.

Consequently, the text of the proposal presented incorporates those specific provisions aimed at amending the CSDR in the appropriate sections to facilitate attainment of its objectives (improving the efficiency of settlement in the EU and the solidity of CSDs) to the extent that they have been evaluated.

Settlement discipline regime

The proposed changes in this area have an impact on the provisions contained in Article 7 of the CSDR. To begin with, a specification is introduced to the effect that a settlement fail caused by factors not attributable to the participants in the transaction or where a transaction does not involve two trading parties will not be subject to the penalty mechanism (nor to the mandatory buy-in mechanism). In this regard, the Commission is empowered to specify both these situations.As regards cash penalties, the proposed regulation specifies that they will be calculated either until the end of the buy-in process (if the Commission has adopted the relevant implementing act) or until the actual settlement date, whichever is earlier.
Additionally, a provision is introduced whereby the Commission may adopt an implementing act specifying to which financial instruments or categories of transactions mandatory buy-ins should apply, providing it considers that such measures are proportionate. It also specifies that the extension period for financial

instruments traded on an SME growth market is calculated on the basis of calendar days.

A new feature of this discipline regime is the provision of a pass-on mechanism to avoid a cascade of failed settlements each requiring a separate buy-in process, such that only one buy-in is necessary to resolve the whole chain of transactions. Consequently, the intermediate receiving participant will be considered as complying with the obligation to execute a buy-in against the failing participant where the end receiving participant executes the buy-in for those financial instruments. Similarly, the intermediate receiving participant may pass-on to the failing participant its obligations toward the end receiving participant.

In turn, in order to ensure that the buy-in restores the participants in the transaction to the position that they would have had if the transaction had taken place, it is proposed that the difference between the price of the financial instruments agreed at the time of the trade and the price paid for the execution of the buy-in be paid by the participant benefitting from such price difference. This compensation must be paid no later than the second business day after the delivery of the instruments subject to the buy-in.

Regarding central counterparties (CCPs), a clarification is introduced as regards the exemption that is provided, specifying that it applies only when the CCP interposes itself between counterparties. There is also a provision to the effect that if CCPs incur losses from the application of mandatory buy-ins, they may establish in their rules a mechanism to cover such losses.

In cases in which it is necessary to address serious threats to financial stability or the orderly functioning of financial markets in the Union, a measure is introduced providing for the suspension of the buy-in mechanism for specific categories of financial instruments. The power to make this decision rests with the Commission, although it must be preceded by a recommendation from ESMA, after consulting the European System of Central Banks (ESCB) and the European Systemic Risk Board (ESRB).

Cooperation between competent authorities and relevant authorities, review, evaluation and recovery and orderly wind-down strategies

In the first place, the proposal incorporates a consultation mechanism between competent authorities and relevant authorities with an impact on the authorisation procedures and on the review and evaluation processes of CSDs. The amendments introduced provide for a process whereby the relevant authorities consulted can issue a reasoned opinion within three months of receiving the information from the competent authority. For their part, the competent authorities will take these opinions into account in their resolutions, in addition to informing them without delay about the results of the authorisation process and, periodically (at least every two years), about the results of the review and evaluation of CSDs. The proposal also considers the processes for authorisation to provide banking-type ancillary services, introducing an extension of the period (from one to two months) in which the competent and relevant authorities can issue a reasoned opinion.In case the authorisation of a CSD is withdrawn, CSDs must have in place procedures that include not only the transfer of assets of clients and participants to other CSDs but also the transfer of issuance accounts and records linked to the provision of core services (central maintenance and notary services).
Another of the changes proposed in this area relates to the minimum periodicity of the review and evaluation process of the CSDs by NCAs, going from every year to every two years. Also, the requirement to draw up resolution plans is removed, and instead it is proposed to introduce specific clarifications in the plans required for recovery or orderly wind-down.

Passporting regime and corporate or similar law of the Member State under which the securities are constituted

In relation to the corporate law by virtue of which the securities are constituted, it is proposed to include a reference to make it clear that this means not only the corporate or similar law applicable to the issuer by reason of its establishment, but also the corporate law by virtue of which the securities in question are issued (in order to capture certain cases such as that of bonds issued by an issuer located in one Member State but contractually subject to the law of another Member State). It also proposes that the Member States assume a

periodic update (every 2 years) of the list of the most relevant provisions in their countries in this regard.Similarly, when the financial instruments have been constituted in accordance with the law of a Member State other than that of the Member State in which the issuer is established, both legislations will be taken into account in the provision of notary services and/or central maintenance services for financial instruments.
Regarding the freedom to provide services, including the opening of branches, in another Member State under the passporting regime, a provision is included to allow new CSDs to process a passporting application in parallel with an authorisation application, so that they can start their cross-border activity from the date of authorisation by their home competent authority provided that at least one month has elapsed since the date of communication of the passporting request by the home competent authority to the host competent authority. Strikingly, the new wording restricts the role of the host Member State such that its approval is no longer necessary for a CSD to start providing services in its territory. As an additional detail, in general, CSDs applying to a host competent authority for a passport are required always to provide an assessment of the measures they intend to take to allow their users to comply with national legislations.

In order to shorten the communication periods, it is proposed to reduce (from 3 months to 1) the time within which the home authority must communicate the passporting request to the host authority. In addition, in the proposal the provision corresponding to the communication of the host authority that was necessary for the beginning of the provision of services of the requesting CSD disappears.

Colleges of supervisors

In this area, criteria are introduced for the establishment of colleges of supervisors for CSDs that provide their services under the passporting regime and for CSDs that are part of a group with two or more CSDs. Where a CSD falls into both categories, it will also be possible to establish just one college for the CSD in question, but only if the relevant competent authorities agree. Provisions are also proposed with criteria for the appointment of the chair of the college, its composition and its functions, all with the aim of contributing to a coherent supervisory approach throughout the EU. Furthermore on the operation of these colleges, it is provided that ESMA will be empowered to develop draft technical standards.Amendments are introduced throughout the text to ensure that colleges are informed of important decisions taken in respect of their respective CSDs. It is further provided that ESMA be notified of the composition of the colleges (via their chairs) and any changes therein within thirty days, and that ESMA for its part maintain an updated list on its website of the colleges with their members.
Third country CSDs and end of the grandfathering clause

In relation to the framework for third country CSDs, firstly, the proposal introduces a new obligation for CSDs to submit a notification to ESMA when they intend to provide settlement services for financial instruments constituted under the law of a Member State. In this regard, ESMA is empowered to draft regulatory technical standards (RTS) to specify the information to be provided by the third-country CSD to ESMA in that notification, limiting it to what is strictly necessary.In addition, when the notification refers to notary or central maintenance services and recognition by ESMA is required, ESMA must adopt a fully reasoned decision within six months of the date of submission of a complete request or the date of adoption of an equivalence decision by the Commission, whichever is later.
As far as the grandfathering clause for the authorisation regime is concerned, it is proposed to introduce an end date for all CSDs. The proposed end date is one year from the date of entry into force of the Regulation for EU CSDs and three years date of entry into force of the Regulation for third country CSDs (due to the equivalence and recognition processes required in the latter case).

In addition, it is proposed that third country CSDs offering notary and central maintenance services in relation to financial instruments constituted under the law of a Member State and also benefitting from the grandfathering clause be required to submit a notification to ESMA in which they report on their activities. ESMA will have to draw up the appropriate RTS to specify the information that must be provided. Similarly, a notification requirement is also introduced for third-country CSDs offering settlement services before the entry into force of this Regulation.

Banking-type ancillary services

The proposed amendments in relation to this area provide that banking-type ancillary services may be provided by CSDs with express authorisation to do so to other CSDs that do not have this authorisation (whether or not they are part of the same group). In addition, the prohibition on designated credit institutions being able to offer core CSD services (notary services, central maintenance and settlement services) is eliminated.Apart from this, as regards the threshold below which CSDs could use a credit institution for banking services, a mandate is introduced so that the European Banking Authority (EBA), in cooperation with the ESCB and ESMA, develop draft RTS to be adopted by the Commission, so as to adequately calibrate this threshold. In this context, it should be noted that the proposal also includes amendments aimed at introducing adequate prudential requirements and consistency with other applicable regulations: certain supervisory requirements are explicitly established and a series of minor issues in the field of risk management are specified. In this regard, the proposed amendments introduce clarifications on qualifying liquid resources, prearranged funding arrangements, non-committed arrangements and netting arrangements, among others.

Organisational requirements

Finally, the procedure for granting CSD authorisation provides that when an applicant CSD does not meet all the requirements at the time of the request, the competent authority may grant the authorisation on the condition that it complies with them when it actually begins its activities.

Useful link:

Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 909/2014 as regards settlement discipline, cross-border provision of services, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories