European Association of CCP Clearing Houses

EACH CSDR Settlement Discipline Framework – Updated Version

May 2024

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1 Introduction

The European Association of CCP Clearing Houses (**EACH**) has been representing the interests of Central Counterparties (**CCPs**) in Europe since 1992. EACH currently has 18 Members from 14 European countries and is registered in the European Union (**EU**) Transparency Register under number 36897011311-96.

The regulatory background for this document is 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 236/2012 (**CSDR**) and its subsequent review process as adopted in December 2023 (CSDR Review). CSDR is complemented by various Implementing Technical Standards and Regulatory Technical Standards (**RTS**) published by the European Banking Authority and European Securities and Markets Authority (**ESMA**).

The aim of CSDR is to harmonise certain aspects of the settlement cycle and settlement discipline and to provide a set of common requirements for Central Securities Depositories (**CSDs**) for both domestic and cross-border transactions. One of the main objectives of CSDR is to improve the safety and efficiency of securities settlement by ensuring that buyers and sellers receive their securities and money on time and without undue risk.

In particular, CSDR provides a set of measures to prevent and address failures in the settlement of securities transactions (settlement fails) commonly referred to as the settlement discipline regime (or 'SDR'). The settlement discipline regime is codified in CSDR and the related 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.

CSDR requirements regarding settlement discipline affect wider financial market infrastructures in addition to CSDs themselves, including CCPs and trading venues.

This document represents EACH's CSDR Settlement Discipline Framework (**Framework**). Its objective is to provide ESMA, relevant authorities and market participants with details of EACH's implementation of the CSDR settlement discipline provisions that affect CCPs and their Clearing Members.

2 Key considerations

1. This Framework is applicable to all CCPs subject to CSDR. Should a CCP not comply with the Framework in a specific aspect (e.g. due to legislative or operational boundaries), it will inform EACH and the CCP's participants.

2. This Framework may be subject to change due to shifting working assumptions and discussions with the European Commission (EC), ESMA, the European Central Securities Depositories Association (**ECSDA**) and/or the market community.

3. This Framework follows the structure of the law. If a certain aspect is not relevant to CCPs or does not give rise to further clarification, it will not be dealt with in this document.

4. This Framework will be shared with all relevant stakeholders (i.e. Clearing Members, CCPs, CSDs, market participants, ESMA and other EU and national authorities).

5. All discussions pertaining to the Framework were conducted in accordance with the EACH Competition Law Provisions.

This Framework references the following documents:

- CSDR
  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 236/2012

- CSDR Review
  Regulation (EU) 2023/2845 of the European Parliament and of the Council of 13 December 2023 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 and amending Regulation (EU) No 236/2012

- SDR
  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.

- Amendment of Article 19 SDR
  COMMISSION DELEGATED REGULATION (EU) 2023/1626 of 19 April 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.

- EU Short Selling Regulation (SSR)
  Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps Text with EEA relevance

- Calculation of Cash Penalties Technical Advice
  Commission Delegated Regulation (EU) 2017/389 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council as regards the parameters for the calculation of cash penalties for settlement fails and the operations of CSDs in host Member States.
- Q&A
  Questions and Answers, Implementation of the Regulation (EU) No 909/2014 on improving securities settlement in the EU and on central securities depositories.

3 Population of settlement instructions (Article 5 SDR)

Article 5 and 6(4) CSDR requires participants to settle their transactions on the intended settlement date (**ISD**). In order to facilitate this, CSDR mandates that CSDs implement specific matching criteria for settlement instructions (Article 5 and 13 SDR). As direct or indirect participants at CSDs, CCPs are expected to follow the same matching criteria for settlement instructions as all other market participants.

Discussed in this section are matching fields according to Article 5(3) SDR and additional mandatory fields according to Article 5(4) and 13 SDR in so far as they impact CCPs. For the full list of matching and additional mandatory fields, see the mentioned regulatory provisions.

3.1 Trade date and CCP netting (Article 5(3) SDR)

Article 5(3) SDR states that the trade date is a mandatory matching field for settlement instructions. Depending on the netting model used by a CCP, this requirement may have a unique impact on CCPs and their Clearing Members.

The method by which CCPs net trades falls into two categories:

- Netting based on the trade date – Trade Date Netting (**TDN**)
- Netting based on the settlement date – Settlement Date Netting (**SDN**)

3.1.1 Netting based on trade date

Where CCPs use TDN, commonly for equity and equity styled products, the trade date of any net trade is the same as its constituent gross trades. In this scenario, the trade date poses no issue when matching settlement instructions.

3.1.2 Netting based on settlement date

SDN is usually the standard for fixed income trades and repurchase (repo) transactions. This allows the netting of a closing leg of a repo trade with the same settlement date as the opening leg of another repo trade. As the settlement date is used as a netting criteria, SDN models may net several trades with different trade dates together.

Currently, CCPs using these netting models send settlement instructions with the trade date as either “ISD”, “ISD-1”, “Date in which the instructions are sent to the CSD”, or “the date of the first trade.” As no single standard is mandated by CSDR, respective CCPs will continue to send settlement instructions with their preferred ‘trade date’ denotation.

In any case, CCPs will keep records of the underlying transactions behind the net trade with their corresponding trade dates.

3.2 Transaction type (Articles 5(4) and 13(1)(d) SDR)

Article 5(4) SDR mandates a transaction type indication for all settlement instructions. This field serves as information and for monitoring and reporting settlement fails as required by Article 13(1)(d) SDR.

Currently, CCPs send settlement instructions with transaction type "NETT", "NETE", or "TRAD". As no single standard is mandated by CSDR, respective CCPs will continue to send settlement instructions with their preferred 'transaction type' denotation.

In any case, CCPs will keep records of the underlying transactions behind the net trade with their corresponding transaction types.

3.3 Place of clearing (Article 13(1)(e) SDR)

Where applicable, Article 13(1)(e) SDR tasks CSDs to collect information regarding the place of clearing. CCPs will identify their own transactions by including either their Bank Identifier Code (**BIC**) or Legal Entity Identifier (LEI) in the 'place of clearing' field.

3.4 Place of trading (Article 13(1)(e) SDR)

3.4.1 General

According to Article 13(1)(e) SDR, CSDs must also collect the place of trading where applicable. Some CCPs clear and net trades executed on multiple trading venues. Currently, CCPs send such net transactions to CSDs with a place of trading value of "blank", "VARI", "EXCH", or "the place of trading of the first trade of the net". As no single standard is mandated by CSDR, respective CCPs will continue to send settlement instructions with their preferred 'place of trading' denotation.

3.4.2 Cleared trades on Small and Medium-sized Enterprise growth markets

Under CSDR, Small and Medium-sized Enterprise (**SME**) growth market transactions are subject to different penalties and buy-in regimes. CCPs will therefore create separate netted instructions for SME growth markets and non-SME growth markets. Accordingly, the 'place of trading' field in settlement instructions will accurately denote an SME growth market trade.

It is possible that identical instruments are traded on multiple SME growth markets. Due to the possibility of different SME growth markets adopting different time frames for the buy-in (Article 7(3) CSDR), CCPs have three options of handling netting in SME growth markets:

1. Deny their Clearing Members the option of netting multiple SME growth markets (i.e. one separate net per SME growth market);

2. Use a new SME growth market code regardless of how many SME growth markets are involved in a net trade. Note, however, that this option can only apply to those SME growth markets that maintain the same buy-in regime (15 days).

3. Use several new universally recognised Market Identifier Code (**MIC**) designating a net trade of SME growth market trades for each possible buy-in regime. This option is not currently being progressed. Therefore, trades on SME growth markets that deviate from the standard buy-in regime will not be netted with any other SME growth markets.

Ultimately, CCPs will disclose to their Clearing Members which solutions they shall permit.

4 Cash penalties

4.1 Introductory remarks

To encourage market participants to settle transactions on time, CSDR introduced a standardised penalty regime that all CSDs must enforce vis à vis their participants. CSDR and its settlement discipline regime makes special provision for CCPs:

- Article 7(4) CSDR (post CSDR Review) means that a CCP may establish in its rules a mechanism to cover losses that it could incur resulting from imbalances from the penalties mechanism.
- Article 7(3)(c) CSDR exempts failing participants which are CCPs from the cash penalties regime outlined in Article 7(2) CSDR and Articles 16 to 20 SDR.
- Article 19 SDR provides for a separate penalty mechanism where the participant is a CCP. This has been amended, so from September 2024, such penalties will now be handled by CSDs in the same way as all other cases.
- Article 19 SDR also provides that a 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).

4.2 Calculation and application of cash penalties

4.2.1 Re-instructions of settlement transactions placed after ISD

Article 16(3) SDR states that when settlement instructions are matched after ISD, cash penalties for the period between ISD and the business day prior to the matching day shall be paid by the last participant who has entered or modified the relevant settlement instruction. Where re-instructions of settlement transactions are placed after ISD, this provision has the potential to unduly harm CCPs and their Clearing Members through the triggering of a second round of late matching penalties. Consider:

1. When a buy-in is partially executed and the CCP chooses to defer the rest of the buy-in, the failing counterparty and the CCP are obliged to cancel their original failed instructions and re-instruct the transaction with the amended settlement quantity and amount, but with the original ISD. Since a buy-in necessarily indicates that the ISD has passed, the re-instructing party will automatically be charged late matching penalties.
2. When manually splitting (partialling) and/or netting-off settlement transactions, existing transactions must be cancelled. At the earliest, these actions can be done on ISD, but they often occur days after ISD. As the ISD of these transactions does not change, late matching penalties will unjustifiably be charged.
3. When buyer protection is enacted on part of a settlement undergoing an elective corporate action, the existing settlement instruction must be cancelled and re- instructed according to the buyer's decision. As corporate actions typically take several days to

process, the re-instruction may also occur after ISD, thus incurring unjustified late matching penalties.

As the first case is considered in the regulation (Articles 16(3) third subparagraph in conjunction with Article 23 and 27(2) SDR), CSDs should provide an appropriate solution. T2S has introduced a new indicator to denote a re-instruction arising from a partial buy-in, exempting that transaction from late matching penalties.

In the second scenario (manual splitting), the hold and release mechanism in T2S will be amended such that instructions may be partially released without the need to cancel and re-instruct any transactions.

In other scenarios, such as the second outside T2S and the third scenario, avoiding double penalization remains problematic. Tentatively, once available, the second and third scenarios may be resolved by using the same partial buy-in indicator as intended for the first scenario.

However, since the CSDR buy-in rules were not enforced this functionality has not been widely implemented by CSDs, including T2S, so this remains an issue. It appears the CSDs will not be dealing with this double counting across the industry so will need to be resolved as now, between CCPs and their members.

4.2.2 Penalties mismatch scenarios

Where a mismatch scenario as described below arises, the CCPs propose to cover the deficit by either mutualizing the cost among their Clearing Members on a fair basis or establishing clear rules by which to assign the cost to particular Clearing Members. Should the CCP be the cause of a mismatch e.g. because of a technical failure, each CCP will address the issue with their Clearing Members and their national competent authorities as they see fit. Per Article 7(4) CSDR and the amended Article 19 SDR, a CCP can recover losses stemming from imbalances from the penalties, and may establish the relevant rules in its rulebook.

4.2.2.1 CCP holding securities overnight

There are potential scenarios in which CCPs may be left holding securities overnight on cleared business. As a result the fails into the CCP are less than the fails out from the CCP and hence the penalty calculations made by the CSDs on each fail would leave the CCP with a loss. EACH does not believe that this is the intention of the Regulation according to Article 7(3)(c) CSDR. Remedies are therefore required.

The following two scenarios were identified:

1. A CCP receives securities into its account towards the very end of the CSD settlement window and the CSD does not deliver the securities out to a receiving Clearing Member as it closes its settlement process. That is, the settlement out would have happened were it not for the hard CSD cut-off. Some CSDs already protect CCPs from such a hard cut-

off and others are working towards minimizing such cases.[2] However, the possibility of such a scenario remains.

2. Receiving Clearing Members have not enabled partial settlement. The best solution is to require all Clearing Members to accept any partial settlement as part of a CCPs internal rules and regulations. In cases where Clearing Members do not abide by such rules the CCP would seek remedy from the offending receiving Clearing Member.

4.2.2.2 SME growth market trades settling against non-SME growth market trades

All trades executed on an SME growth market are subject to the penalties regime for SME growth markets as defined in the Annex of the Calculation of Cash Penalties Technical Advice. However, some of these instruments can also be traded on regular trading venues or over the counter (OTC). As these financial instruments are identical, while CSDs may be able to distinguish between financial instruments settled for an SME growth market trade and a non-SME growth market trade, they currently have no intention to use this notion in the settlement algorithm. Consider the following scenario:

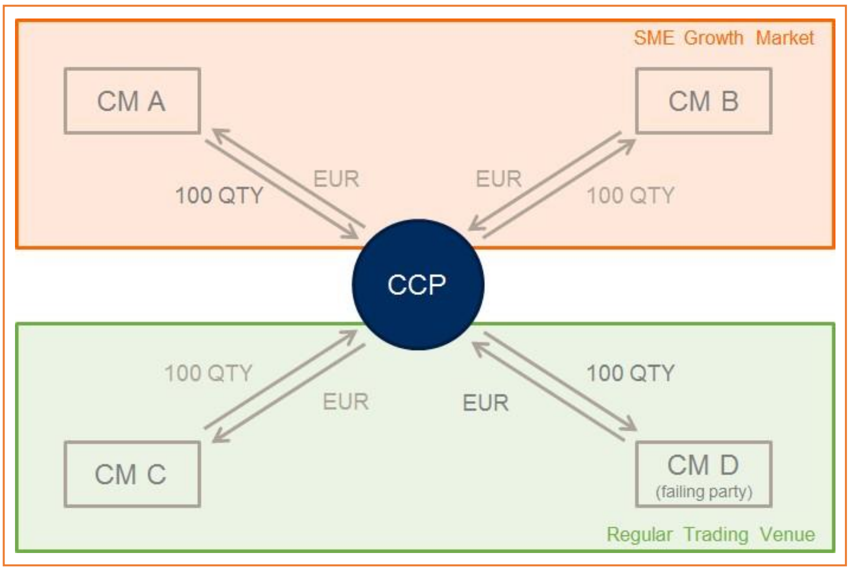

Figure 1: Trading of identical securities on both an SME and a regular market

If CM C settles before CM A, the CSD might deliver the securities to CM B rather than CM D, resulting in two remaining open transactions:

[2] E.g. T2S CR T2S-0689-SYS.

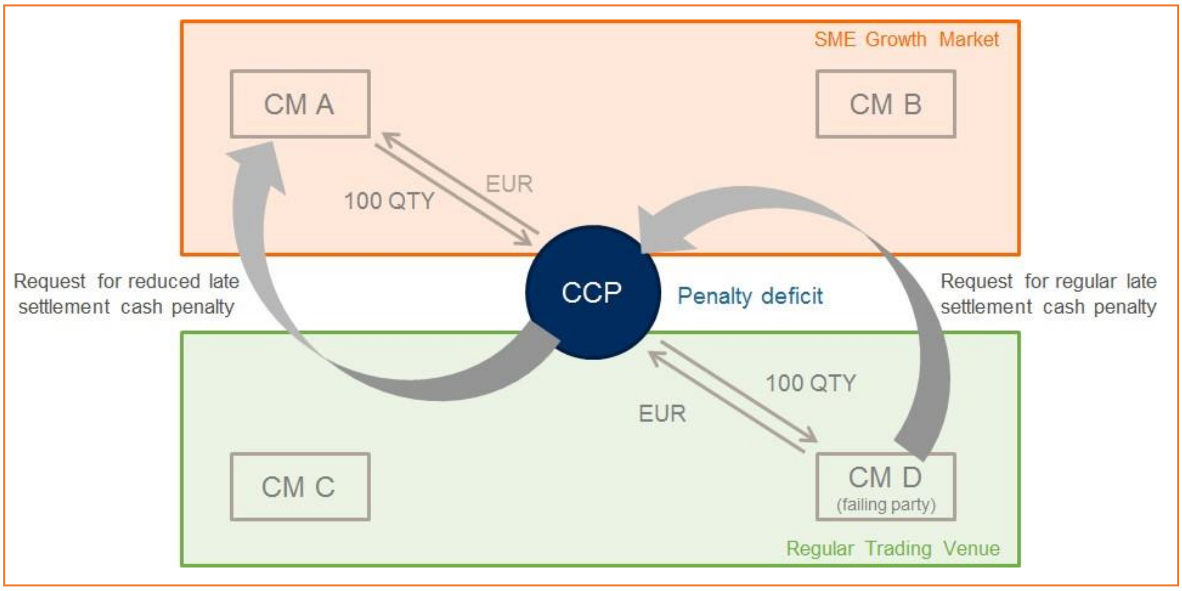

Figure 2: Possible scenario once CM C fulfils its obligation to the CCP

In this case, the CCP will be left with a penalty deficit due to the reduced penalties levied on SME growth market trades.

4.2.2.3 Strange nets and resulting penalties

So called strange nets may occur after CCPs have performed their netting function, resulting in a non-receipt versus payment (RVP)/DVP transaction. Certain such strange nets may generate problematic penalty scenarios. Consider a case where a CCP has the following three failing settlements:

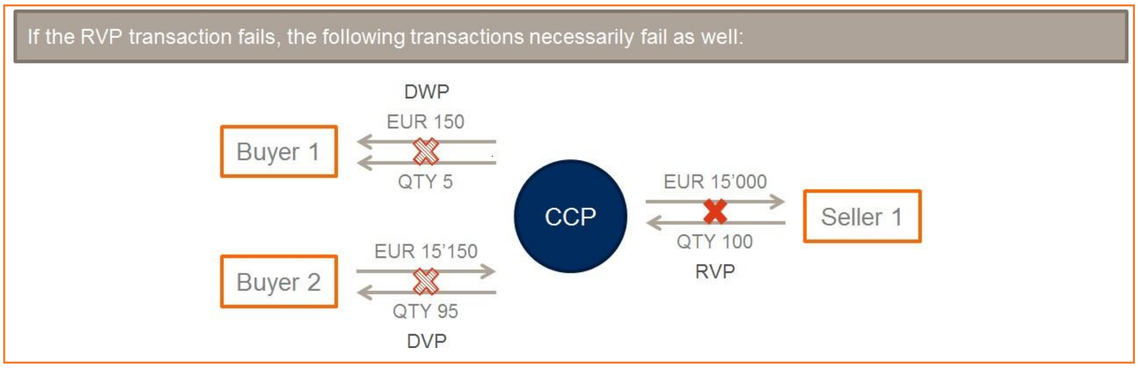

Figure 3: Example of a CCP transaction in which strange nets may occur

According to penalty calculation methods, the CCP will be charged two separate penalties for the failure of the delivery with payment (**DWP**) transaction to Buyer 1:

- a penalty based on the non-delivered securities (QTY 5); and
- a penalty based on the non-paid cash amount (EUR 150).

The failed securities delivery will be covered by the failed securities penalty from Seller 1. However, as the CCP is failing to deliver securities to Buyer 2 it will not receive a cash fail penalty from Buyer 2, and in particular not for the EUR 150 which it then fails to pay Buyer 1.

4.2.3 Market-wide technical production issues and resulting penalties

Scenarios may arise where, due to market-wide technical production issues, the CCP fails to send settlement instructions to the market on time. Due to this failure to instruct, late settlement and late matching penalties may occur.

Every CCP is entitled to deal with the resulting penalties as it sees fit.

5 Buy-in process under EU SSR

Given that the CSDR review has put the proposed mandatory buy-ins on hold, the pre-existing buy-ins for cleared share fails have been re-introduced into the SSR.

6 Consistent and systematic failure to deliver financial instruments

According to Article 7(9) CSDR, "CSDs, CCPs, and trading venues shall establish procedures that enable them to suspend in consultation with their respective competent authorities, any participant that fails consistently and systematically to deliver" financial instruments. While the metrics of a consistent and systemic failing counterparty is defined in Article 39 SDR, the procedures to suspend a systemically failing CSD participant shall be coordinated between the relevant CCPs, CSDs, trading venues, and the competent authorities.

Appendix

Abbreviation	Explanation
BIC	Bank Identifier Code
CCP	Central Counterparty
CSD	Central Securities Depository
CSDR	Regulation (EU) No 909/201 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 236/2012
DVP	Delivery versus payment
EACH	European Association of CCP Clearing Houses
ECSDA	European Central Securities Depositories Association
ESMA	European Securities and Markets Authority
ESMA Q&A	Questions and Answers, Implementation of Regulation (EU) No 909/2014 on improving securities settlement in the EU and on central securities depositories
ETFs	Exchange Traded Funds
EU	European Union
Framework	EACH's CSDR settlement discipline Framework
ISD	Intended settlement date
MIC	Market Identifier Code
PoA	Power of Attorney
RTS	Regulatory Technical Standards
SDR	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
SD	Settlement Date
SDN	Settlement Date Netting
SME	Small and Medium-sized Enterprise
TD	Trade Date
TDN	Trade Date netting

Abbreviation	Explanation
T2S	TARGET2-Securities: Settlement System
TDN	Trade Date Netting

- END -