



European Securities and
Markets Authority

Guidelines

CSD participants default rules and procedures

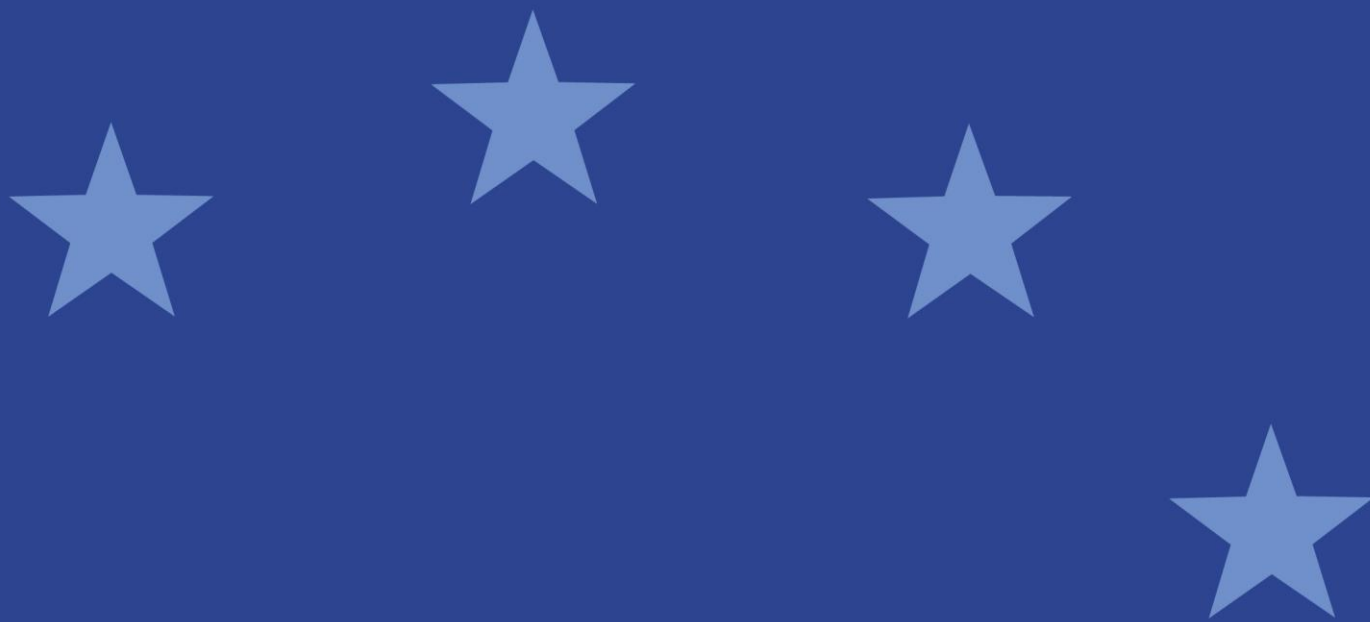




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1 Scope

Who?

1. These guidelines apply to competent authorities.

What?

2. These guidelines apply in relation to the rules and procedures the CSD shall set up to address a participant default pursuant to Article 41 of Regulation (EU) No 909/2014.

When?

3. These guidelines apply from the date that is two months after their publication on the ESMA's website in all official languages of the EU.



2 Definitions

4. Unless otherwise specified, terms defined in the Regulation (EU) No 909/2014 have the same meaning in these guidelines. In addition, the following definitions apply:

<i>Commission Delegated Regulation (EU) 2017/392</i>	Commission Delegated Regulation (EU) 2017/392 of 11 November 2016 supplementing regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to the technical standards on authorisation, supervisory and operational requirements for central securities depositories
<i>CPSS-IOSCO Principles for Financial Market Infrastructures</i>	Principles for financial market infrastructures, April 2012, by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO)
<i>Directive 98/26/EC</i>	Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems
<i>EC</i>	European Commission
<i>ESMA</i>	European Securities and Markets Authority
<i>EU</i>	European Union
<i>Regulation (EU) No 909/2014</i>	Regulation (EU) No 909/2014 of the European Parliament and of the Council 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 No 236/2012
<i>Regulation (EU) No 1095/2010</i>	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC



3 Purpose

5. The purpose of these guidelines is to ensure common, uniform and consistent application of the provisions in Article 41 of Regulation (EU) No 909/2014. In particular, they aim at ensuring CSDs define and apply clear and effective rules and procedures to manage the default of any of their participants (this shall cover all types of participants, i.e. including participants that are CSDs or other types of market infrastructures and, in those Member States that have chosen to consider indirect participants as participants, pursuant to Article 2(f) of Directive 98/26/EC, also indirect participants).
6. As the concept of “*default*” itself is already defined under Regulation (EU) No 909/2014 in relation to a participant as “*a situation where insolvency proceedings (...) are opened against a participant*”, the purpose of these Guidelines is not to specify further the concept of “*default*” in relation to a participant, but only to provide guidance on the steps a CSD should set up and follow in case such default occurs.
7. Directive 98/26/EC defines “insolvency proceedings” as “any collective measure provided for in the law of a Member State, or a third country, either to wind up the participant or to reorganise it, where such measure involves the suspending of, or imposing limitations on, transfers or payments” (Article 2(j)) and the moment of opening of an insolvency proceeding against a participant as the moment when the relevant judicial or administrative authority handed down its decision (Article 6(1)). Directive 98/26/EC also provides that, in such case, such authority shall immediately notify its decision to the appropriate authority chosen by its Member State and that the Member State shall immediately notify the European Systemic Risk Board, other Member States and ESMA (Article 6(2) and (3)).
8. As mentioned in recital 6 of Regulation (EU) No 909/2014, ESMA should ensure consistency with the CPSS-IOSCO Principles for Financial Market Infrastructures when drawing up guidelines to Regulation (EU) No 909/2014.
9. In this respect, one might notice that the scope of the CPSS-IOSCO Principles for Financial Market Infrastructures is indeed wider than that of these guidelines as it provides that “*an FMI should provide in its rules and procedures what circumstances constitute a participant default, addressing both financial and operational defaults*”, specifying that “*an operational default occurs when a participant is not able to meet its obligations due to an operational problem, such as a failure in information technology systems*”.
10. It is important to note that, although Regulation (EU) No 909/2014 uses a rather narrow definition of “default”, this does not prevent CSDs from establishing other procedures to address events affecting their participants other than the opening of formal insolvency proceedings against them.



4 Compliance and reporting obligations

4.1 Status of the guidelines

12. This document contains guidelines issued under Article 41(4) of Regulation (EU) No 909/2014 in accordance with Article 16 of Regulation (EU) No 1095/2010. Article 16(3) of Regulation (EU) No 1095/2010 requires competent authorities and financial market participants to make every effort to comply with guidelines and recommendations.
13. Competent authorities to whom the guidelines apply should comply by incorporating them into their supervisory practices and monitor whether CSDs comply with them.

4.2 Reporting requirements

14. Competent authorities to whom these guidelines are addressed must notify ESMA whether they comply or intend to comply with the guidelines, with reasons for non-compliance, within two months of the date of their publication on the ESMA's website in all official languages of the EU to CSDR.Notifications@esma.europa.eu.
15. In the absence of a response by this deadline, competent authorities will be considered as non-compliant. A template for notifications is available from the ESMA website.



5 Guidelines

5.1 Definition of the participant default rules and procedures

5.1.1 Procedure for establishing participant default rules and procedures

1. In developing its default rules and procedures for each of the securities settlement systems it operates, a CSD should involve any relevant stakeholders, including, but not limited to, its participants (possibly through the consultation of its user committees), other relevant market infrastructures (CSDs, entities settling the cash leg of securities transactions settled through the CSD, CCPs and trading venues), and, where using a common settlement infrastructure, the operator of such infrastructure.
2. The default rules and procedures of a CSD should be approved by its management body.

5.1.2 Acknowledgement of a participant's default

3. The implementation by a CSD of its default rules and procedures should be activated once a CSD, after having taken all reasonable steps to verify its occurrence, has identified a participant default.
4. A CSD may be informed of the default of one of its participants by the participant itself, the authority designated according to Article 6(2) of the Directive 98/26/EC in the Member State of the CSD, the CSD's competent authority, the defaulting participant's competent authority or any other person with knowledge of the existence of the default, such as a CCP, a trading venue, a linked CSD or the operator of a common settlement infrastructure used by the CSD.
5. To this end a CSD should request its participants to notify their default to it as soon as possible and should specify through which channels such notification should be made.
6. As soon as it is informed of a default of a participant, the CSD should transmit this information, including details available at that moment in time and the source of information, to its competent authority. Following this it should, as soon as possible, identify and transmit to its competent authority at least the additional information listed below:
 - the type of participant in respect of which the default has occurred (i.e. information such as legal status, license, activity, whether it is a key participant under Article 67 of the Commission Delegated Regulation (EU) 2017/392),
 - the total volume and value of the defaulting participant's settlement instructions that are pending settlement and if possible of those that may fail to settle, with "value" being calculated as specified in Article 42(2) of the Commission Delegated Regulation (EU) 2017/392 on the day of the default;



- the type of transactions and financial instruments (with the categories used respectively in Articles 54(2)(b) and 42(1)(d)(i) of the Commission Delegated Regulation (EU) 2017/392) those instructions relate to,
- when applicable, in which common settlement infrastructure the defaulting participant's settlement instructions are processed and, when available, any other indicators of cross border activities of the participant in default,
- where known to the CSD, the number of clients the defaulting participant has, and
- information on any material risks that such default might entail.

5.1.3 Actions a CSD may take in case of default

7. A CSD should indicate in its default rules and procedures which actions it may take when a default occurs in respect of one of its participants, including the measures it may take to contain losses and liquidity pressures, at and after the point of participant default. The CSD should specify whether those actions are automatic or decided on a case-by-case basis.
8. The actions could include, to the extent permitted under applicable law and, in particular, in compliance with the settlement finality rules defined in Directive 98/26/EC:
 - (a) changes to the normal settlement practices, such as blocking the entry of additional settlement instructions in its securities settlement systems by the defaulting participant, suspending its non-final settlement instructions from settlement, or restricting certain functionalities that can be applied to the settlement instructions of that participant such as setting an end-date for the recycling of a settlement instruction;
 - (b) use by the CSD of financial resources: where relevant, the CSD should specify in its rules and procedures which are those financial resources (such as, for a CSD without a banking licence, a guarantee fund if in place or for a CSD authorised to provide banking-type ancillary services, the collateral provided by its participants), the order in which they would be used and the measures and procedures to address the timely replenishment of such resources following a default.
9. The default rules and procedures of a CSD should specify the consequences of the actions it may take in respect of defaulting and non-defaulting participants' settlement instructions and accounts.

5.1.4 Implementation of the default rules and procedures

10. The CSD should specify the criteria to be taken into account for the choice of each of the actions listed in its default rules and procedures.



11. The CSD should have rules and procedures that clearly delineate the responsibilities of the various parties, both within its organisation and, as appropriate, outside it, for addressing a participant default, and provide training and guidance to its personnel on how the default rules and procedures should be implemented. These rules and procedures should identify key personnel for this purpose, address communications, documentation, information needs and data access issues, and coordination with other entities, including, as appropriate, other market infrastructures, and, for CSDs using a common settlement infrastructure, the operator of such infrastructure.

5.1.5 Communication on the implementation of the default rules and procedures

12. The default rules and procedures of a CSD should provide that:
 - (a) The CSD should notify as soon as possible its competent authority and the defaulting participant of the actions to be taken or taken by the CSD following the default;
 - (b) The CSD should inform the following persons as soon as possible of the actions taken by the CSD following the default:
 - i. its relevant authorities;
 - ii. ESMA
 - iii. its non-defaulting participants;
 - iv. the trading venues and CCPs served by the CSD;
 - v. the operator of the common settlement infrastructure used by the CSD;
 - vi. the linked CSDs.
13. Information provided to the persons referred to in points iii. to vi. of letter (b) of paragraph 12 should not contain personal data within the meaning of point (a) of Article 2 of Directive 95/46/EC¹ (except in cases where the defaulting participant is a natural person).

5.2 Periodic testing and review of participant default rules and procedures

14. The default rules and procedures of a CSD should specify the mechanisms and timing to test their effectiveness and practicality.

¹ "personal data" shall mean any information relating to an identified or identifiable natural person ('data subject'); an identifiable person is one who can be identified, directly or indirectly, in particular by reference to an identification number or to one or more factors specific to his physical, physiological, mental, economic, cultural or social identity", Directive 95/46/EC of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data



15. A CSD should perform such tests at least annually and, in any case, following any substantive changes to the CSD default rules and procedures or upon request from its competent authority, with a relevant sample of its participants, relevant market infrastructures (CSDs, entities settling the cash leg of securities transactions settled through the CSD, CCPs and trading venues) and any other entities (such as the operator of a common settlement infrastructure the CSD uses, third parties to which the provision of services has been outsourced, etc.), as appropriate, for each of the securities settlement systems it operates. The competent authority of the CSD may request to take part in such tests.
16. Prior to each test, a CSD should define the parameters according to which such test should be run, taking into account different types of participants (in terms of volume, activity, etc.), participants located in different countries or time zones, participants holding different types of accounts (omnibus and segregated), relevant market infrastructures, as appropriate. Such test should include a simulation exercise and a test of the communication procedures. If so requested by the competent authority, a CSD may submit the parameters it intends to use to its competent authority prior to each test.
17. Where a test reveals any weakness in its default rules and procedures, the CSD should modify them accordingly. Where the simulation exercise reveals the lack of knowledge or readiness to apply the default rules and procedures by its participants or other market infrastructures, the CSD should make sure that these entities are duly informed and take actions to remove such weaknesses.
18. The results of any test and the contemplated changes to its default rules and procedures, if any, should be shared with the CSD's management body, risk committee, competent authority and relevant authorities. The CSD should also disclose at least a summary of the results of a performed test and, the contemplated changes to its default rules and procedures, if any, to its participants.