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From: Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director

date of receipt: 23 October 2020

To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

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Subject: COMMISSION DELEGATED REGULATION (EU) .../... of 23.10.2020 amending Delegated Regulation (EU) 2018/1229 concerning the regulatory technical standards on settlement discipline, as regards its entry into force

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Delegations will find attached document C(2020) 7186 final.

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Encl.: C(2020) 7186 final



Brussels, 23.10.2020  
C(2020) 7186 final

**COMMISSION DELEGATED REGULATION (EU) .../...**

**of 23.10.2020**

**amending Delegated Regulation (EU) 2018/1229 concerning the regulatory technical standards on settlement discipline, as regards its entry into force**

(Text with EEA relevance)

## EXPLANATORY MEMORANDUM

### 1. CONTEXT OF THE DELEGATED ACT

Regulation (EU) No 909/2014 ('the Regulation')<sup>1</sup> harmonises the conduct of securities settlement in the Union and the rules governing central securities depositories (CSDs). One of the main objectives of the Regulation is to improve the safety and efficiency of securities settlement, in particular for cross-border transactions, by ensuring that buyers and sellers receive their securities and money on time and without risks. To achieve this objective, the Regulation harmonises the timing and framework for securities settlement in the Union. In particular, it provides for a set of measures to prevent and address failures in the settlement of securities transactions ('settlement fails'), commonly referred to as settlement discipline measures.

Against this background, the Regulation empowers the Commission to adopt, following submission of draft regulatory technical standards by the European Securities and Markets Authority ('ESMA'), and in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010 establishing ESMA<sup>2</sup>, a delegated Regulation specifying further the settlement discipline measures set out in the Regulation. Commission Delegated Regulation (EU) 2018/1229<sup>3</sup> on settlement discipline, specifies the following:

- (a) measures to prevent settlement fails, including measures to be taken by financial institutions to limit the number of settlement fails as well as procedures and measures to be put in place by CSDs to facilitate and incentivise timely settlement of securities transactions;
- (b) measures to address settlement fails, including the requirements for monitoring and reporting of settlement fails by CSDs; the management by CSDs of cash penalties paid by their users causing settlement fails; the details of an appropriate buy-in process following settlement fails; the specific rules and exemptions concerning the buy-in process and the conditions under which a CSD may discontinue its services to users that cause settlement fails.

Commission Delegated Regulation (EU) 2018/1229 enters into force on 1 February 2021.

On 26 August 2020, ESMA adopted a report suggesting to the Commission the postponement of the entry into force of Commission Delegated Regulation (EU) 2018/1229. To this effect, ESMA proposed an amendment to Commission Delegated Regulation (EU) 2018/1229.

In accordance with Article 10(1) of Regulation (EU) No 1095/2010, the Commission shall decide within three months of receipt of the draft regulatory standards whether to endorse the draft submitted. The Commission may also endorse those draft regulatory standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in that Article.

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<sup>1</sup> 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 Directive 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (OJ L 257, 28.8.2014, p. 1).

<sup>2</sup> 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 (OJ L 331, 15.12.2010, p. 84).

<sup>3</sup> 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 (OJ L 230, 13.9.2018, p. 1).

The new settlement discipline regime under the Regulation will affect a wide range of market participants (CSDs, CCPs, trading venues, investment firms, credit institutions) and authorities, and will require significant IT system changes, market testing and adjustments to legal arrangements between the parties concerned.

The T2S penalty mechanism is a major development in the T2S landscape to support T2S CSDs in their compliance with the settlement discipline regime, providing a single source for the calculation and reporting of cash penalties. Substantial implementation efforts have to be deployed both at the level of the Eurosystem and of the CSDs, including for testing activities, in order to accommodate the testing requirements commanded by the implementation of a major functionality. Market participants across the value chain (e.g. clients of CSD participants) will also need to mobilise substantial time and resources to adapt to the new cash penalty framework. Although the majority of EU CSDs are part of T2S, other CSDs may face similar constraints, as well as the CSD participants that will be subject to the cash penalty regime.

Another important change brought about by the settlement discipline regime is the mandatory buy-in process. The buy-in process requires significant changes to current market practices and contractual arrangements, involving a wide range of market participants (CSDs, CCPs, trading venues, investment firms, credit institutions), and major IT developments, including new or updated ISO messages.

Additionally, CSDs have to change their systems and procedures and have to put in place new functionalities in order to facilitate and incentivise settlement on the intended settlement date, as well as in order to monitor and address settlement fails.

Finally, CSDs have to send monthly and annual settlement fails reports to the competent and relevant authorities, which in turn will be sent by competent authorities to ESMA. For this, CSDs, competent authorities and ESMA have to put in place IT systems for the submission and the reception of the reports, which will be based on ISO 20022 compliant messages.

The initial date of entry into force of Commission Delegated Regulation (EU) 2018/1229 was 13 September 2020. On 8 May 2020, the European Commission adopted Commission Delegated Regulation (EU) 2020/1212 amending Delegated Regulation (EU) 2018/1229 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline<sup>4</sup>, which postponed this date until 1 February 2021 to allow more time for the above mentioned developments. However, according to input from stakeholders, due to the pressure from the COVID-19 pandemic on core operations, activities not strictly related to contingency plans and running the business had to be unavoidably de-prioritised as of March 2020 in most jurisdictions. Indeed, as indicated by the Commission in previous communications related to COVID-19<sup>5</sup>, the severe economic shock caused by the COVID-19 pandemic and the exceptional containment measures have had far-reaching impacts on markets. In particular, financial institutions had to carry on their activities on a remote basis, which put their IT resources under considerable pressure. As a consequence, IT developments which were on-going before March 2020 in order to ensure the implementation of the different aspects of the settlement discipline regime were severely impacted and delayed, thereby preventing market players and

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<sup>4</sup> Commission Delegated Regulation (EU) 2020/1212 of 8 May 2020 amending Delegated Regulation (EU) 2018/1229 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline, OJ L 275, 24.8.2020, p. 3–4

<sup>5</sup> Communication from the Commission to the European Parliament and the Council COM(2020) 169 final - Commission Interpretative Communication on the application of the accounting and prudential frameworks to facilitate EU bank lending Supporting businesses and households amid COVID-19

CSDs alike to be ready for the implementation of Commission Delegated Regulation (EU) 2018/1229 by the new deadline in February 2021. In particular, the Commission has been made aware that the COVID-19 pandemic prevented a number of CSDs from making the necessary changes to their systems which would have allowed them to start testing the collection and redistribution of cash penalties. Requiring CSDs, their participants and clients to start applying cash penalties without having had the appropriate time to adequately calibrate their systems and making the necessary testing would lead to increased risk, especially in the context of the ongoing COVID-19 pandemic. This also applies to the other aspects of the settlement discipline framework.

Having regard to the severe impact of the COVID-19 pandemic on the overall implementation of regulatory and IT projects by CSDs and their participants, as well as by other financial market infrastructures, a further delay in the entry into force of the relevant rules is required in order to ensure a date of entry into force which allows the appropriate IT adjustments to be made in a timely and safe manner. Considering the uncertainties on the evolution of the COVID-19 pandemic in the near future and its impacts on the market's preparedness as well as the possible impact of any potential new measure to cope with COVID-19, a one year postponement is considered as adequate and proportionate<sup>6</sup>. It should be noted that the temporary delay of the entry into force of certain requirements in order to ensure that financial institutions are able to address the challenges posed by the COVID-19 pandemic is not unprecedented. Amongst others, at international level, the Basel Committee on Banking Supervision (BCBS) has announced a one-year delay in the internationally agreed deadline to implement the final Basel III standards in order to free up the operational capacity of banks and supervisors. Furthermore, such a postponement ensures a response to the COVID-19 pandemic impacts at European level avoiding national fragmentation and uncoordinated action. It seems therefore appropriate for the Commission to endorse the draft RTS as submitted by ESMA.

## 2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

On 26 August 2020, ESMA adopted a report proposing a delay in the entry into force of Commission Delegated Regulation (EU) 2018/1229. Given that the proposed amendment is limited in scope and is targeted to address specific issues raised by the concerned market participants, ESMA did not conduct any open public consultation in accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1095/2010 (*"the Authority shall conduct open public consultations on draft regulatory technical standards and shall analyse the potential related costs and benefits, unless such consultations and analyses are highly disproportionate in relation to the scope and impact of the draft regulatory technical standards concerned"*). This was also justified in view of the numerous representations received by ESMA explaining the severe impact of the COVID-19 pandemic on the preparedness of CSDs, their participants and their clients. However, ESMA requested the advice of the Securities and Markets Stakeholder Group and conducted a high-level analysis of the costs and benefits. More specifically, in its analysis ESMA noted that this proposal would have several benefits. First, it would give sufficient time for market participants and authorities to finalise the necessary IT system changes that have been delayed due to COVID-19 pandemic, to develop and update the relevant ISO messages, and to put in place the legal arrangements needed for the implementation of the settlement discipline regime under the

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<sup>6</sup> See press release "Governors and Heads of Supervision announce deferral of Basel III implementation to increase operational capacity of banks and supervisors to respond to Covid-19", 27 March 2020, available at: <https://www.bis.org/press/p200327.htm>.

RTS on settlement discipline. Second, it would also help avoid the risk of non-compliance with legal requirements due to technical impossibilities. Third, it would reduce the risk of disorderly and fragmented implementation due to the heterogeneity of COVID-19 national situations and measures, as delaying the date of entry into force to a later date should allow for a more harmonised implementation across the EU. Fourth, the expected impact of the proposed change will represent a relief for market participants and authorities. Finally, it would provide legal certainty and transparency for the market. As to the costs, ESMA concluded that no additional cost should be envisaged. Therefore, ESMA reached the conclusion that the benefits of its proposal outweigh the costs. ESMA also cooperated closely with the members of the European System of Central Banks. Stakeholders have also contacted the Commission in support of a delay in the entry into force of Commission Delegated Regulation (EU) 2018/1229.

### **3. LEGAL ELEMENTS OF THE DELEGATED ACT**

The proposed Commission Delegated Regulation postpones the entry into force of Commission Delegated Regulation (EU) 2018/1229 from 1 February 2021 to 1 February 2022.

Taking into account the severe impact of the COVID-19 pandemic on the overall implementation of regulatory and IT projects by CSDs and their participants, as well as by other financial market infrastructures, it seems appropriate to set the date for the entry into force of Commission Delegated Regulation (EU) 2018/1229 at 1 February 2022.

The proposed Commission Delegated Regulation should enter into force three days following the day of its publication in the Official Journal, to ensure that it enters into force before Commission Delegated Regulation (EU) 2018/1229 does.

**COMMISSION DELEGATED REGULATION (EU) .../...**

**of 23.10.2020**

**amending Delegated Regulation (EU) 2018/1229 concerning the regulatory technical standards on settlement discipline, as regards its entry into force**

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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<sup>7</sup>, and in particular Article 6(5) and Article 7(15) thereof,

Whereas:

- (1) Commission Delegated Regulation (EU) 2018/1229<sup>8</sup> specifies measures to prevent and address settlement fails, and to encourage settlement discipline. Those measures include monitoring settlement fails as well as collecting and distributing cash penalties for settlement fails. Delegated Regulation (EU) 2018/1229 also specifies the operational details of the buy-in process.
- (2) Delegated Regulation (EU) 2018/1229 is to enter into force on 1 February 2021.
- (3) Market participants have indicated that the COVID-19 pandemic has had a serious impact on the overall implementation of regulatory projects and delivery of information technology (IT) systems that are necessary for the application of Delegated Regulation (EU) 2018/1229. During this unprecedented time, financial institutions are focusing their efforts on the implementation of effective contingency plans to ensure day-to-day operational and cyber resilience, which limited the IT capacity of institutions to carry out certain complex projects, including for those required to comply with the settlement discipline requirements set out in Delegated Regulation (EU) 2018/1229. The application of such requirements by CSDs, their participants and clients in such a context could lead to increased risk in the financial market rather than mitigating it. It is, therefore, appropriate to provide those stakeholders with more time to complete the necessary preparations required for the application of the settlement discipline requirements. Considering the unprecedented nature of the situation created by the COVID-19 pandemic and the necessary system changes that CSDs, their participants and their clients should undergo to comply with the different settlement discipline requirements, a further one-year deferral of the current entry into force of Delegated Regulation (EU) 2018/1229 is necessary. .

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<sup>7</sup> OJ L 257, 28.8.2014, p. 1

<sup>8</sup> 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 (OJ L 230 13.9.2018, p. 1).

- (4) Delegated Regulation (EU) 2018/1229 should therefore be amended accordingly.
- (5) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Securities and Markets Authority (ESMA).
- (6) ESMA has not conducted any open public consultations, as it would be deemed highly disproportionate given the scope and the expected impact of the deferral of the entry into force of Delegated Regulation (EU) 2018/1229. ESMA has taken account of the previously provided input from the market participants regarding readiness for the application of that Regulation. Moreover, in these unforeseen circumstances it is urgent to provide legal certainty as to a new date of entry into force of Delegated Regulation (EU) 2018/1229 in order for market participants to prepare for the application of that Regulation. ESMA has nevertheless conducted an analysis of the potential related costs and benefits of deferring the entry into force of Delegated Regulation (EU) 2018/1229 and has requested the advice of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council<sup>9</sup>. In developing the draft regulatory technical standards, ESMA has also cooperated with the members of the European System of Central Banks,

HAS ADOPTED THIS REGULATION:

*Article 1*

Article 42 of Delegated Regulation (EU) 2018/1229 is replaced by the following:

'Article 42

**Entry into force**

This Regulation shall enter into force on 1 February 2022.'

*Article 2*

This Regulation shall enter into force on the third day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 23.10.2020

*For the Commission*

*The President*

*Ursula VON DER LEYEN*

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<sup>9</sup> 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 (OJ L 331, 15.12.2010, p. 84).