

Get Set for Settlement Discipline with Monte Titoli

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- ***Settlement discipline*** [CSDR, Commission Delegated Regulation (EU) 2018/1229 (SDR)]

✓ **ESMA work on SD**

✓ **Buy-in**

ESMA work on SD – QAs (Penalties) (1)

- Almost all ESMA QAs so far refer to «Cash Penalties»:

- **Joint penalty mechanism**

Art. 20 SDR

- ✓ Q – Is the use of a common framework or rulebook sufficient in order to satisfy the requirement for a joint establishment and joint management of the cash penalty mechanism under Article 20 of the RTS on Settlement Discipline?
- ✓ A – **NO** ... the penalty mechanism should be jointly established, managed and operated by the respective CSDs. This should include at least:
 - I. the joint governance and legal enforceability of common rules and procedures ... ;
 - II. the use of common reference data and prices;
 - III. the use of a single calculation engine, which does not require reconciliation operations amongst the involved CSDs

ESMA work on SD – QAs (Penalties) (2)

- **Calculation – Several clarifications as to how to calculate penalties in specific circumstances, what rate to apply, etc, e.g.:**
 - ✓ Q – When should penalty rates for financial instruments traded on SME growth markets apply?
 - ✓ A – The penalty rates for SME growth market instruments should only apply if the particular trade has actually taken place on an SME growth market.

In order for these penalty rates to apply, the same information identifying the relevant SME growth market should be included in the field related to the place of trading in both corresponding settlement instructions.

ESMA work on SD – QAs (Penalties) (3)

■ Scope

- ✓ Q – Are there exceptional situations where the cash penalty mechanism provided for under Article 7(2) of CSDR should not be applied?
- ✓ A – **YES** ...
- ✓ Q – How should Article 7(12) of CSDR apply in respect of cash penalties due to, and owed by, [an insolvent] participant ... ?
- ✓ A – ... Article 7(2) shall cease to apply to the settlement fails caused by the insolvent participant ...

ESMA work on SD – Guidelines

- **Standardised procedures and messaging protocols (Article 6(2) of CSDR)**
 - ✓ Final report published in English on 8 October 2019
 - ✓ Translations?
- **Settlement Fails Reporting (Article 7(1) of CSDR)**
 - ✓ Consultation Paper published on 20 December 2018

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- *Settlement discipline*

- ✓ ESMA work on SD

- ✓ Buy-in

Scope of the Buy-in

- ***Comprehensive approach***

Art. 7(10) CSDR

- ✓ *Transactions cleared by a CCP*
- ✓ *Market transactions not cleared by a CCP*
- ✓ *OTC transactions not cleared by a CCP*

Contractual arrangements and procedures

- All parties in the settlement chain shall: Art. 25 SDR
 - ✓ establish contractual arrangements with their counterparties incorporating the buy-in process obligations and ensure that the arrangements are enforceable in all relevant jurisdictions; and
 - ✓ set up the appropriate procedures in order to ensure they can implement the buy-in process without delay

Key concepts (1)

▪ Price difference

Art. 7(6) CSDR
Art. 35 SDR

- ✓ *The buy-in is executed*
- ✓ *The difference between the buy-in execution price and the trade price*

▪ Cash compensation

Art. 7(7) CSDR
Artt. 32-33 SDR

- ✓ *The buy-in is not executed*
- ✓ *The difference between the market price and the trade price*

▪ Buy-in costs

Art. 7(8) CSDR
Art. 34 SDR

- ✓ *The buy-in is executed*
- ✓ *Costs other than the «price difference»*

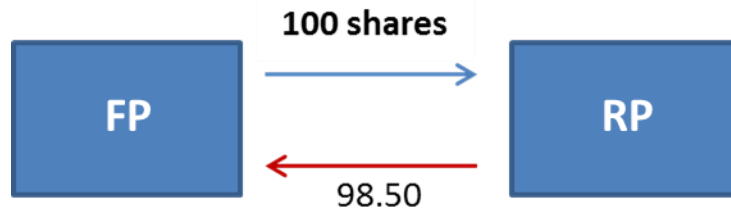
Key concepts (2): Delivery

- *Bought-in securities delivered directly to the Receiving Participant*
 - ✓ *Original settlement instructions to be cancelled*
 - ✓ *New settlement instruction to be entered in the SSS at the end of each BD, for the quota of securities not already bought-in (buy-in partially executed) [penalties apply]*

Price Difference – Securities

FP = Failing Participant

RP = Receiving Participant



P = Trade price = 98.50

$P_{\text{BUY-IN}}$ = Buy-in price

Two scenarios:

I. $P_{\text{BUY-IN}}$ lower than P

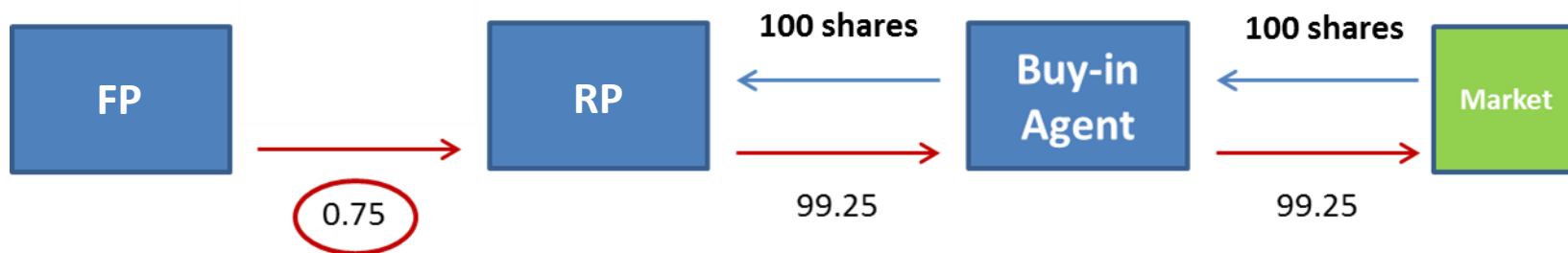
II. $P_{\text{BUY-IN}}$ higher than P

Buy-in price higher than trade price – Securities

$P = 98.50$

$P_{\text{BUY-IN}} = 99.25$

Art. 35(1) SDR



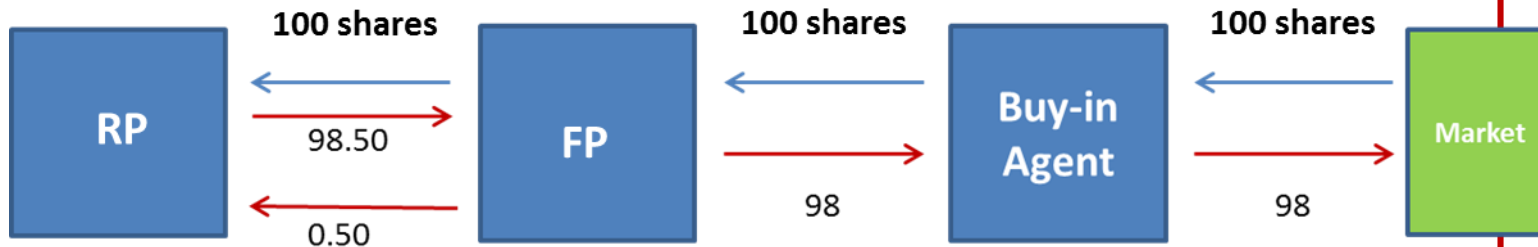
Price difference

Remember:
delivery
directly to the
RP

Buy-in price lower than trade price (1) - Shares

$P = 98.50$
 $P_{\text{BUY-IN}} = 98$

Price difference - Shares
Art. 7(6) CSDR



Price difference

Requires payment of the price difference

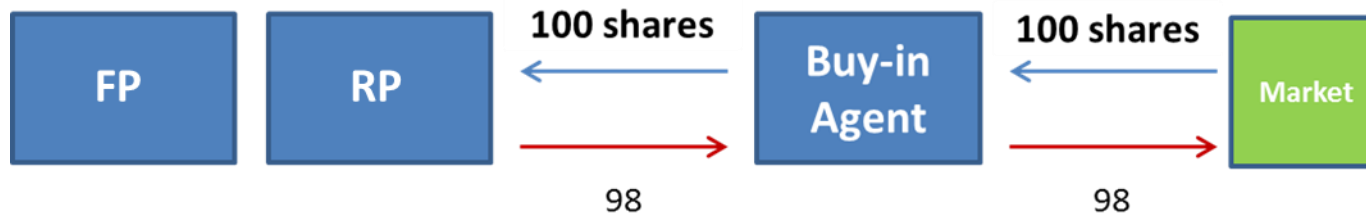
Assumes (implicitly) delivery to the FP and settlement of the original settlement instruction

Buy-in price lower than trade price (2) - Shares

$P = 98.50$

$P_{\text{BUY-IN}} = 98$

Price difference - Shares
Art. 35(2) SDR



Remember:
delivery
directly to the
RP

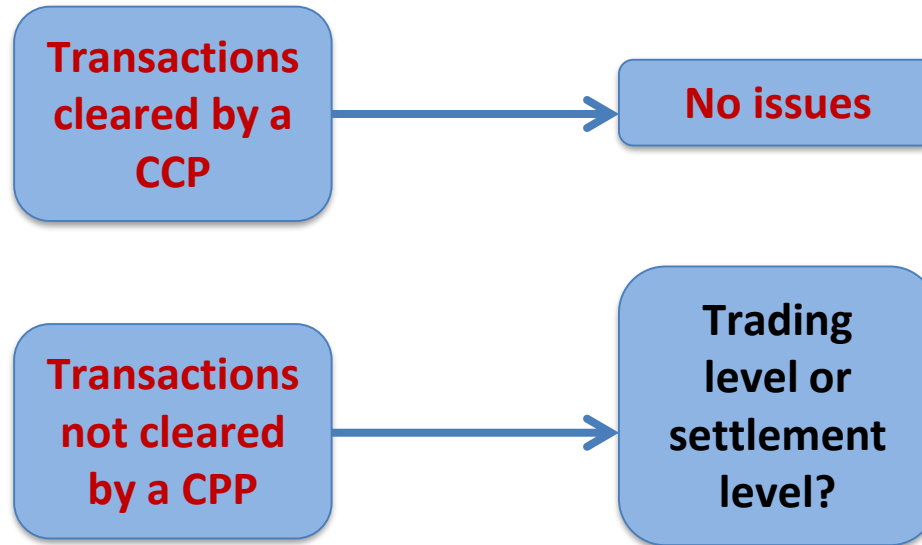
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The price difference
in case of shares
«shall be deemed
paid»

Buy-in price lower than trade price (3)

- *The provisions under Art. 7(6) CSDR and 35(2) SDR only apply to:*
 - ✓ *Shares*
 - ✓ *Payment of the price difference*
- *The provisions under Art. 7(6) CSDR and 35(2) SDR do not apply to:*
 - ✓ *Securities other than shares*
 - ✓ *Payment of the cash compensation*

Who will pay (be responsible for) what to whom?



Price Difference, Cash Compensation, Buy-in Costs (CSDR)

Art. 7(6)

«the corresponding [price] difference shall be paid to the receiving participant by the **failing participant**»

Failing participant
is mentioned

Art. 7(8)

«the **failing participant** shall reimburse the entity that executes the buy-in for all amounts paid...»

Failing participant
is mentioned

Art. 7(7)

«cash compensation shall be paid to the receiving participant»

Failing participant
is not mentioned

Price Difference, Cash Compensation, Buy-in Costs (SDR)

Transactions not cleared by a CCP

Recital 35

« ... the failing trading venue member or the failing trading party, as applicable, should ... bear responsibility for the payment of the buy-in costs, the price difference and the cash compensation in the first place.

Where the failing trading venue member or failing trading party do not comply with their obligation to pay those amounts, their participant, as the failing participant, should, however, cover the **buy-in costs** and the **price difference** ...

... but not the **cash compensation**.»

Trading level
«responsible in
the first place»

BUT

**The failing
participant could
be called to pay**

**The failing
participant should
not be called to pay**