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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 (Text with EEA relevance)

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

(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[(1)], and in particular Article 7(14) and Article 24(7) thereof,

Whereas:

(1) The provisions of this Regulation are closely linked since they deal with the elements required for the implementation of the measures laid down in Regulation (EU) No 909/2014. To ensure coherence between those measures and to facilitate a comprehensive view and easy access by persons that are subject to these provisions, it is desirable to include all these elements concerning measures under Regulation (EU) No 909/2014 in a single Regulation.

(2) Regulation (EU) No 909/2014 requires that central securities depositories (CSDs) impose cash penalties on participants to their securities settlement systems that cause settlement fails (failing participants).

(3) To ensure that cash penalties imposed on failing participants act as an effective deterrent, the parameters for the calculation of the level of cash penalties should be closely related to the value of financial instruments that fail to be delivered, and to which appropriate penalty rates should be applied. The value of the financial instruments underlying the transaction should also be the basis for the calculation of the level of cash penalty where the settlement fail is due to a lack of cash. The level of cash penalties should provide incentives to failing participants to promptly settle transactions that failed to be settled. In order to ensure the effective achievement of the objectives pursued by the imposition of cash penalties, the adequacy of the parameters for their calculation should be monitored on an ongoing basis and adjusted, as necessary, on the basis of the impact of those penalties on the market.

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(4) In view of the considerable price differences of financial instruments in the multiple underlying transactions and in order to facilitate the calculation of cash penalties, the value of financial instruments should be based on a single reference price. The same reference price should be used by CSDs on a given day for calculating cash penalties for settlement fails concerning identical financial instruments. Cash penalties should be therefore the result of multiplying the number of financial instruments underlying the transaction that failed to settle by the relevant reference price. The establishment of reference prices should be based on objective and reliable data and methodologies.

(5) Taking into account that the automation of calculations of cash penalties should ensure their effective application by CSDs, appropriate penalty rates should be based on a single table of values that should be easy to automate and apply. Penalty rates for different types of financial instruments should be set at levels that would result in cash penalties that fulfil the conditions of Regulation (EU) No 909/2014.

(6) Settlement of transactions in shares is usually highly standardised. Where shares have a liquid market and could therefore be bought easily, settlement fails should be subject to the highest penalty rate in order to provide incentives to failing participants to settle failed transactions in a timely manner. Shares that do not have a liquid market should be subject to a lower penalty rate given that a lower penalty rate should still have a deterrent effect without affecting the smooth and orderly functioning of the markets concerned.

(7) The level of cash penalties for settlement fails of transactions in debt instruments issued by sovereign issuers should take into account the typically large size of these transactions and their importance for the smooth and orderly functioning of the financial markets. Settlement fails should therefore be subject to the lowest penalty rate. Such a penalty rate should nevertheless have a deterrent effect and provide an incentive for timely settlement.

(8) Debt instruments that are not issued by sovereign issuers have less liquid markets and the size of transactions in such instruments is smaller. Such debt instruments also affect the smooth and orderly functioning of the financial markets less than debt instruments issued by sovereign issuers. The penalty rate for settlement fails should therefore be higher than for debt instruments issued by sovereign issuers.

(9) Settlement fails of transactions in debt instruments should be subject to lower penalty rates than settlement fails of transactions in other financial instruments in view of their overall larger size, non-standardised settlement, greater cross-border dimension and importance for the smooth and orderly functioning of the financial markets. Such lower penalty rate should nevertheless have a deterrent effect and provide an incentive for timely settlement.

(10) Financial instruments other than shares and debt instruments that fall within the scope of Regulation (EU) No 909/2014, such as depository receipts, emission allowances and exchange-traded funds, do not usually have a highly standardised settlement and liquid markets. They are also often traded over-the-counter (OTC). In view of the limited volume and size of transactions and in order to reflect their non-standardised trading

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and settlement, settlement fails should be subject to a similar penalty rate to the one for shares that do not have a liquid market.

(11) The parameters for calculating cash penalties should be adapted to the specificities of certain trading venues, such as SME growth markets as defined in Directive 2014/65/EU of the European Parliament and of the Council[(2)]. Cash penalties for settlement fails should not hinder access by small and medium enterprises (SMEs) to capital markets as an alternative to bank lending. In addition, Regulation (EU) No 909/2014 allows SME growth markets the flexibility not to apply the buy-in process to settlement fails until up to 15 days after the intended settlement date. Consequently, cash penalties for settlement fails in financial instruments traded on SME growth markets may apply during a longer period of time than for other financial instruments. Given the length of application of cash penalties, lower liquidity and specificities of SME growth markets, the penalty rate for settlement fails of transactions in financial instruments traded on such trading venues should be set at a specific rate that should provide incentives for timely settlement but should not affect their smooth and orderly functioning. It is also appropriate to ensure that settlement fails of transactions in certain financial instruments, such as debt instruments traded on such venues, are subject to a lower penalty rate than similar debt instruments traded on other markets.

(12) Settlement fails due to a lack of cash should be subject to a single penalty rate for all transactions given that such a situation is independent from the asset type and liquidity of the financial instrument concerned or the type of transaction. In order to ensure a deterrent effect and incentivise timely settlement by failing participants through cash borrowing, it is appropriate to use the costs of borrowing cash as a basis for the penalty rate. The most appropriate penalty rate should be the official interest rate of the central bank issuing the settlement currency that should evidence the borrowing costs for that currency.

(13) Regulation (EU) No 909/2014 allows CSDs to provide their services in the Union under the supervision of competent authorities of their home Member States. To ensure an appropriate level of safety in the provision of services by CSDs in host Member States, Regulation (EU) No 909/2014 requires the competent and relevant authorities of home Member States and host Member States to establish cooperation arrangements for the supervision of the activities of CSDs in the host Member State when their operations become of a substantial importance for the functioning of the securities markets and the protection of investors in the host Member States concerned.

(14) To comprehensively establish whether the operations of CSDs have become of substantial importance for the functioning of the securities markets and the protection of investors in host Member States, it is appropriate to ensure that assessment criteria consider the core services provided by CSDs in host Member States as specified in Section A of the Annex to Regulation (EU) No 909/2014 given that such core services are provided by CSDs in their capacity as financial market infrastructures.

(15) For the purposes of assessing the importance of the operations of CSDs in host Member States, the assessment criteria should consider the size of the core services provided by CSDs to users from host Member States, including to issuers, participants in securities

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settlement systems or other holders of securities accounts maintained by CSDs. Where the size of core services provided by CSDs to users from host Member States is sufficiently large, the operations of CSDs in such host Member States should be deemed to be of substantial importance for the functioning of the securities markets and the protection of investors given that any failures or deficiencies in the operations of such CSDs may affect the smooth functioning of securities markets and the protection of investors in the host Member States concerned. In order to ensure a comprehensive assessment, it is appropriate to apply assessment criteria which consider independently the size of each core service provided by CSDs to users from host Member States.

(16) Where CSDs issue or centrally maintain large parts of securities for issuers established in host Member States or where they centrally maintain large parts of securities accounts for participants of their securities settlement systems or other account holders established in host Member States, their operations should be deemed to be of substantial importance for the functioning of the securities markets and the protection of investors in the host Member States concerned.

(17) Where CSDs settle large values of transactions in securities issued by issuers established in host Member States or where they settle large values of settlement instructions from participants and other holders of securities accounts established in host Member States, their operations should be deemed to be of substantial importance for the functioning of the securities markets and the protection of investors in the host Member States concerned.

(18) Directive 98/26/EC of the European Parliament and of the Council[(3)] allows Member States to designate securities settlement systems governed by their laws for the purposes of application of that Directive when Member States consider that such designation is warranted on grounds of systemic risk. When CSDs operate securities settlement systems designated by host Member States in accordance with Directive 98/26/EC, their operations should therefore be deemed to be of substantial importance for the functioning of the securities markets and the protection of investors in those host Member States.

(19) Assessments of operations of CSDs should be conducted with sufficient frequency in order to allow the authorities concerned to establish without undue delay cooperation arrangements from the moment when the operations of relevant CSDs become of substantial importance for the functioning of the securities markets and the protection of investors in host Member States.

(20) When the operations of CSDs become of substantial importance for the functioning of the securities markets and the protection of investors in a host Member State, they should be deemed to be of substantial importance for a sufficiently long period of time to allow the authorities concerned to establish effective and efficient cooperation arrangements in accordance with Regulation (EU) No 909/2014.

(21) Calculations related to assessments under this Regulation should be based on objective and reliable data and methodologies. Given that certain calculations required under this Regulation are based on the rules laid down in Regulation (EU) No 600/2014 of the

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European Parliament and of the Council[(4)], such calculations should only be undertaken when Regulation (EU) No 600/2014 is applicable.

(22) Given that the measures to address settlement fails related to the calculation of cash penalties and certain measures for the establishing of substantial importance may require significant information technology system changes, market testing and adjustments to legal arrangements between the parties concerned, including CSDs and other market participants, sufficient time should be allowed for the application of the relevant measures to ensure that the CSDs and other parties concerned meet the necessary requirements,

HAS ADOPTED THIS REGULATION:

Article 1

Definitions

For the purposes of this Regulation, 'settlement instruction' means a transfer order as defined in Article 2(i) of Directive 98/26/EC.

Article 2

Calculation of cash penalties

The level of cash penalties referred to in the third subparagraph of Article 7(2) of Regulation (EU) No 909/2014 for settlement fails of transactions in a given financial instrument shall be calculated by applying the relevant penalty rate set out in the Annex to this Regulation to the reference price of the transaction determined in accordance with Article 3 of this Regulation.

Article 3

Reference price of the transaction

1 The reference price referred to in Article 2 shall be equal to the aggregated market value of the financial instruments determined in accordance with Article 7 for each business day that the transaction fails to be settled.

2 The reference price referred to in paragraph 1 shall be used to calculate the level of cash penalties for all settlement fails, irrespective of whether the settlement fail is due to a lack of securities or cash.

Article 4

Criteria for establishing the substantial importance of a CSD

The operations of a CSD in a host Member State shall be considered to be of substantial importance for the functioning of the securities markets and the protection of investors in the host Member State where at least one of the criteria specified in Articles 5 and 6 is fulfilled.