



European Securities and  
Markets Authority

# Final Report

**Guidelines on participant default rules and procedures under Regulation  
(EU) No 909/2014**





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## Acronyms used

CP	Consultation paper on Participant Default Rules and Procedures under CSDR, ref. ESMA/2016/732
CSDR	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
EC	European Commission
ESCB	European System of Central Banks
ESMA	European Securities and Markets Authority
ESMAR	ESMA Regulation <i>i.e.</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
EU	European Union
PFMIs	CPSS-IOSCO 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)
RTS	Regulatory technical standards
SFD	Settlement Finality Directive <i>i.e.</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

# 1 Executive Summary

## Reasons for publication

Article 41 of the Central Securities Depositories Regulation (CSDR) relates to the rules and procedures a CSD should define in order to address one of its participant default. Paragraph (4) of this Article provides that ESMA may issue guidelines in accordance with Article 16 of the ESMA Regulation in order to ensure the consistent application of this Article.

ESMA considers that there is a need to specify further how such rules and procedures should be defined by the CSD and implemented in case of default of a participant, and how such rules and procedures should be tested and reviewed.

This Final Report follows the Consultation Paper issued in May 2016, which presented a first draft of guidelines addressing these issues. A total of 19 responses were received, which allowed ESMA to prepare the final guidelines that are included here as Annex III.

## Contents

Section 2 contains information on the background and mandate, and Section 3 contains the feedback to the responses received to the CP and highlights where ESMA has changed the proposed guidelines following the consultation.

Annex I provides the legislative mandate, Annex II sets out ESMA's view on the costs and benefits associated with these guidelines and **Annex III contains the text of the guidelines.**

## Next Steps

The guidelines in Annex III will be translated into the official languages of the European Union and published on the ESMA website.

Within two months of the publication of the translations, each national competent authority will have to confirm whether it complies or intends to comply with those guidelines. In the event that a national competent authority does not comply or intend to comply with those guidelines, it will have to inform ESMA stating its reasons. ESMA will then publish the fact that a national competent authority does not comply or does not intend to comply with those guidelines.

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## 2 Background and mandate

1. Article 41 of the CSDR on participant default rules and procedures provides that:
  - “1. For each securities settlement system it operates, a CSD shall have effective and clearly defined rules and procedures to manage the default of one or more of its participants ensuring that the CSD can take timely action to contain losses and liquidity pressures and continue to meet its obligations.*
  - 2. A CSD shall make its default rules and relevant procedures available to the public.*
  - 3. A CSD shall undertake with its participants and other relevant stakeholders periodic testing and review of its default procedures to ensure that they are practical and effective.”*
2. Under Article 41(4) of the CSDR, ESMA may issue Guidelines *“in order to ensure consistent application of [Article 41]”*. In preparing these Guidelines, ESMA was required to closely cooperate with members of the ESCB.
3. These guidelines further specify paragraphs (1) and (3) of Article 41 of the CSDR regarding the definition by a CSD of its participant default rules and procedures, including by specifying a non-exhaustive list of actions a CSD may take in order to manage the default of a participant, and set minimal requirements in respect of the testing and review of such rules and procedures. In respect of the public disclosure of such default rules and procedures, it has been considered that there was no need at this stage to specify further the provisions of paragraph (2) of article 41 of the CSDR.
4. As mentioned in recital 6 of the CSDR, ESMA should ensure consistency with the PFMI. In this respect it should be considered that Article 41 of the CSDR already incorporates Principle 13 of the PFMI on participant default rules and procedures. Therefore, in developing its guidelines under Article 41 ESMA needed to ensure consistency with the purpose of Principle 13 of the PFMI and its relevant key considerations.
5. In order to elaborate these guidelines, ESMA has also reviewed regulations issued in respect of other market infrastructures, in particular CCPs, and actual rules published by CSDs.

## 3 Feedback statement

1. The consultation ran between 31 May and 30 June 2016 and received 19 responses from CSDs, markets infrastructures, banks, funds and market industry associations. There were six questions on specific parts of the proposed guidelines, but responses also touched upon other issues raised by the proposal.

## General comments

2. **Scope: definition of “default”.** Some respondents mentioned that the scope should be broadened to situations other than insolvency procedures defined in Settlement Finality Directive (SFD). The SFD aims at reducing the systemic risk associated with participation in payment and securities settlement systems, and in particular the risk linked to the insolvency of a participant in such a system.
3. ESMA considers that the scope of these guidelines should not extend to other situations and has clarified this in the “purpose” section of the guidelines, with direct references to the SFD.
4. **Scope: treatment of CSDs as participants.** One respondent asked to clarify that these rules should also apply to CSD being participants in other CSDs.
5. ESMA has clarified in the “purpose” section of the guidelines that they apply to all participants in the CSD.
6. **Scope: treatment of indirect participants.** The definition of “participant” under the CSDR directly refers to that of the SFD, as is done for the definition of “*default, in relation to a participant*”. Under the SFD, indirect participants may be treated as participants for the purposes of such Directive by a Member State “*if that is justified on the grounds of systemic risk*” (Article 2(f) of the SFD).
7. ESMA therefore considers that, in those Member States that have chosen to treat indirect participants as participants, CSD default rules and procedures should also apply to such indirect participants. This has been clarified in the “purpose” section of the guidelines.
8. **Interaction of CSD default rules with resolution regimes and involvement of resolution authorities.** As a default under the CSDR (through the reference to the SFD) only refers to the opening of an insolvency proceeding in respect of a participant and as that at this stage a resolution proceeding opened in its respect would be over, ESMA does not believe those authorities should be involved.
9. **Interaction of default rules with national insolvency laws.** ESMA has clarified that these default rules may apply only “*to the fullest extent permitted under applicable law*”, which would include any applicable national insolvency law provision.

## Q1 on the establishment of the default rules

10. Most respondents agreed with the proposed list of entities to be involved by the CSD in the establishment of its default rules and procedure.
11. There were suggestions to involve other entities such as:
  - Competent authorities and central banks
  - T2S
  - Resolution authorities, insolvency authorities of the participants

- User committee, CSD's participants
  - Representatives of participants' clients, brokers, custodians or secured creditors of the CSD, payment banks
12. As the proposed list is open-ended, CSDs are free to involve any category of stakeholders in the process of establishing their rules. To clarify this, ESMA inserted "*and other relevant market stakeholders*" at the end of the list.
13. Further to the suggestions made in the responses, ESMA inserted references to "*operators of common settlement infrastructure*" (which would cover T2S), to *user committees* as it considers this could be a way to formalise the involvement of the participants in the elaboration of the default rules and procedures and to "*other relevant market infrastructures*", which covers for instance payment systems.
14. ESMA did not consider necessary to mention the following types of entities:
- Competent authorities and central banks: these authorities will review the default rules anyway in the course of the authorisation process (relevant central banks as relevant authorities of CSDs).
  - Resolution authorities and insolvency authorities of the participants: resolution authorities should not be concerned by this default procedure; as for insolvency authorities, this seems difficult to achieve as it would require to involve every entity that may be in charge of applying an insolvency proceeding (there is no such "insolvency authority") to a participant, even third country authorities.
  - Representatives of participants' clients, brokers, custodians or secured creditors of the CSD, payment banks: it seems difficult for a CSD to involve third parties in the elaboration of its own rules (it is unlikely that the CSD would launch a public consultation on its rules).
15. There was no appetite to specify the level of involvement each involved entity should have.
16. There were further suggestions in relation to the approval of the rules by:
- CSD competent authority: ESMA considers there is no need to add anything as it is already the case through the authorisation process;
  - Participants: ESMA considers that they could be consulted through the involvement of the user committee at the establishment step.

## **Q2 on the acknowledgement of a participant's default**

17. A majority of respondents disagreed with the proposed process (information from a reliable source to be transmitted to CSD competent authority and verified with the SFD-designated authority).



18. The verification step with the relevant SFD-designated authority was particularly criticized by many respondents, notably as being potentially a lengthy process in cases where participants are not located in the same jurisdiction as their CSD, and as being unsuitable to participants located outside of the European Union.
19. One respondent proposed to define a harmonised list of information items to be provided in the notification of the default which could constitute reliable information.
20. Taking into account all these comments, and in particular the fact that the proposed process appeared too rigid, which might hamper the capacity of a CSD to react in a timely manner and that such process was not suitable for third-country participants. Therefore, ESMA deleted the verification step with the CSD competent authority and authority designated under the SFD, and chose not to define what “reliable information” or “reliable sources” should be, to let the CSD make a reasonable assessment of any information received.
21. This modification is also driven by the fact that CSDs can provide for procedures addressing other types of events, including pre-insolvency events, which may be triggered much more easily – and would thus deprive the procedure described in these guidelines of their substance.
22. Regarding the information to be transmitted by a CSD to its competent authority, respondents requested more details in respect of the following items:
  - Type of transactions and financial instruments those instructions relate to: some respondents assumed this information shall be based on categories already defined under the CSDR and related standards. ESMA has clarified that point in the guidelines.
  - Number of clients concerned: a number of respondents wondered who's these clients were (those of the CSD or of the defaulting participant). ESMA has clarified it by referring to the defaulting participant's clients and adding “*where known to the CSD*”.
  - Information on risks such default might entail: a number of respondents claimed that this request should only relate to “material” risks or be deleted – arguing that CSDs should only provide for quantitative information. ESMA has added the word “material” before “risks”.

### **Q3 on the actions a CSD may take in case of default**

#### **General comments**

23. There was a consensus by the respondents that the guidelines should not impose any action to be taken, that the choice of action should be left entirely to the CSD, in line with the case-by-case assessment of the circumstances.





24. ESMA agrees but, in compliance with PFMI, has specified that the rules should indicate how the CSD intends to choose and apply the actions envisaged (whether their application is automatic or mandatory, etc.).
25. Some respondents insisted on the fact that the choice of action should be a decision of the CSD executive board, depending on the specific circumstances of the case.
26. One respondent mentioned that the trigger for action should not be the occurrence of the default but the fact that the application of the default procedure has been activated. ESMA reworded the paragraph in that sense.
27. The proposed list of actions received many comments. They were generally seen as appropriate, although there was a call for additional details.
28. A shared concern related to the interactions with the settlement finality process, and the fact that such rules and procedures should account for that process, in particular for the status of the transactions in a cross-CSD settlement.
29. Also in relation to this, it was mentioned that the impact such procedures may have on transactions should be accounted for in the rules – where some respondents considered it inappropriate that a CSD, not being a part to a transaction could intervene and take actions in (transactions resulting from participant’s client portfolio should continue to be settled against those of non-defaulting participants).
30. ESMA has clarified that all actions a CSD may take were subject to any applicable law, including in particular the rules defined in the SFD on settlement finality and has extensively restructured this section by clarifying that the CSDs were free to list the possible actions, limiting examples to “*changes to normal settlement practices*” and “*use of financial resources*”.

### **Specific comments on the actions proposed**

31. Suspension and termination of participant’s access to all or part of the CSD’s services and functionalities: respondents agreed with the possibility to temporarily suspend a participant, in the meaning of the possibility for the CSD to decide to refuse the entry into its securities settlement system of new settlement instructions by a defaulting participant, once the default has been identified. Respondents rejected the “termination of access” action as this would not allow the settlement of pending settlement instructions and thus oppose the SFD settlement finality process and contractual law.
32. Changes to the normal settlement practices: Most of the comments were requests for more substance on this or examples of the types of changes we want to cover here. As a reminder, this comes from the PFMI with the addition of “*should these changes be necessary in extreme circumstances, to ensure timely settlement*”.

33. ESMA reworded this paragraph quite extensively, by removing reference to “suspension” and “termination”, which seemed to be unclear, and repetitive vis-a-vis “changes to normal settlement practices” action, which has been substantiated, specifying that this could consist for instance into blocking the entry of new settlement instructions by the defaulting participant into the system or limiting the benefit of certain functionalities (recycling, etc.) to pending settlement instructions entered into in the securities settlement system).
34. “Changes to the treatment of proprietary and customer settlement instructions and accounts, also considering the type of accounts (omnibus or individual client segregation)”: As a reminder, this comes from the PFMI, which refer to “the expected treatment of proprietary and customer transactions and accounts” but however seemed to be redundant with “changes to normal settlement practices”,
35. Some respondents argued that the reference to omnibus/segregated accounts should be deleted as a participant’s default should not entail any difference for their clients, as the participant’s assets are ring-fenced from those of its clients, whether having omnibus or individual accounts.
36. ESMA decided to delete the paragraph, and to specify further there what the changes to normal settlement practices could be.
37. “Use of financial resources”: this raised many comments asking whose resources it was (the defaulting participant’s or the CSD’s own resources) and to clarify that non-bank CSDs would not be expected to use their own financial resources.
38. ESMA thus developed this paragraph to specify what kind of measures these could be, and that they were not mandatory, for any type of CSD (whether or not authorized to provide banking-type ancillary services).
39. “Any other mechanism that may be activated to contain the impact of a participant default”: respondents asked for this one to be further specified. As the list has been made open-ended (“The actions could include...”), ESMA deleted this last proposal.

#### **Q4 on the implementation of the default procedures and internal plan**

40. On the requirement for the management body to ensure the CSD has the operational capacity to implement its default rules, some respondents suggested to delete it as this replicates the general requirement on operational capacity in the CSDR. ESMA deleted this paragraph.
41. On the requirement to have an internal plan: some respondents claimed it was disproportionate for non-bank CSDs as it would duplicate the default procedure itself, and generally that there was no need for an additional document.

This requirement comes from the PFMI (CSDs should define “*the roles, obligations, and responsibilities of the various parties, including the non-defaulting participants*”) and we do not see it as an additional document but rather a detailed description of the actual default procedure. We have clarified this by replacing references to “internal plans” by references to the “default rules and procedure”.

42. Other respondents agreed with the proposed list, except for the reference to non-defaulting participants: some said that they should be removed from the list, others that this should be limited to those that are directly impacted by the default, some argued that their roles, obligations and responsibilities are determined by insolvency laws, not in internal plans.
43. ESMA believes however that it would be very difficult to determine who exactly is “directly impacted” by the default, and that it would add too much uncertainty to the process.
44. Further to suggestions from a few respondents to include additional items, ESMA has added references to access to data and key employees.

## **Q5 on the communication relating to the implementation of the default procedure**

45. The purpose of this communication seems to have been misunderstood by some respondents as a communication on the insolvency proceeding itself, one of them arguing that this would already be covered under the reporting requirements and cooperation arrangements provided under both the SFD and the CSDR.
46. ESMA wants to clarify that such reporting requirements and cooperation arrangements actually cover for communication on the actual implementation of such default procedure to an insolvent participant and that this is indeed not covered under the reporting requirements and cooperation arrangements provided under both the SFD and the CSDR.
47. Some respondents specified that determining the “maximum time” to notify the defaulting participants of the actions to be applied to him may be difficult. ESMA changed it for “*the CSD should notify the defaulting participant as soon as possible of the actions taken or to be taken*”.
48. There were also claims that the CSDs should not be subject to a mandatory timetable to inform stakeholders, as these should be calibrated on a case-by-case basis, but there should be recommendation that other market infrastructures are informed as soon as possible.
49. There was a general agreement on the list of stakeholders to be informed, with questions as to whether non-defaulting participants should be informed. There were also suggestions to inform:
  - central infrastructures to which CSDs may outsource the processing of its business, in particular T2S: ESMA added a notification to “*operator of common settlement infrastructure*” in order to address this.



- any other linked FMIs: ESMA considered it was not necessary as the GL already refer to “trading venues and CCPs served by the CSD”.
  - as for information of authorities, only competent authority that would in turn inform the CSD relevant authorities (referred to in Article 12 of the CSDR) and ESMA. ESMA prefers keeping separate direct notifications by the CSD to each authority in order to ensure timely information of all authorities.
50. On the requirement to comply with para. 25 on personal data protection, certain respondents claimed that it would be impossible to comply with it in respect of private individuals as participants (as information will by definition include information regarding individuals).
51. This paragraph is indeed meant to avoid, pursuant to Article 2(a) of the Data Protection Directive<sup>1</sup>, the transfer of information relating to an identified or identifiable natural person (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). This is meant to protect the personnel of the defaulting participant.
52. There were many requests to either delete or clarify the paragraph relating to the information of the competent authority by the CSD prior to taking any action (i.e. clarifying the point that it was merely a prior information of the competent authority and not a request for authorisation to implement any action). ESMA deleted this paragraph.

## **Q6 on the testing and review of the default procedure**

53. Most respondents agreed in principle with the proposed testing procedure.
54. Some respondents however claimed that the frequency and scope should be proportionate to each CSD – in particular an annual test seems to be disproportionate and every 2 or 3 years, in agreement with the competent authority or upon change of the rules, would seem more suitable. However, the PFMI clearly provide for the tests to be run “at least annually”, so ESMA did not make any change.
55. Parties involved: many respondents asked for a close cooperation with the entities managing the default of the participant. However, ESMA considers that this might prove almost impossible to implement (given the possible difficulty to determine the authorities that will effectively manage such default, depending on the type of participant and on the type of insolvency proceeding opened) and chose not recommended it in these guidelines.

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<sup>1</sup> Directive 95/46/EC of the European Parliament and of the Council 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



56. Some respondents argued that the mention of “*participants holding different types of accounts*” should be deleted as segregated and omnibus accounts beneficiaries should have the same protection in case of default of their participant. ESMA chose to keep it, as this comes from the PFMI and that CSDs should consider highlighting in their rules possible differences which might arise in practice.
  
57. Finally, as for the results of these tests, some respondents claimed that they should also be shared with all participants as this should be part of their own risk assessment. ESMA agrees and added that the results should be shared with all participants. This could be done through the CSD’s website, and could consist in the publication of a summary of the results rather than the full outcome of the test and of proposed changes to the rules if needed.



## 4 Annexes

### Annex I – Legislative mandate

#### **Article 41 of Regulation (EU) No 909/2014 - Participant default rules and procedures**

- 1. For each securities settlement system it operates, a CSD shall have effective and clearly defined rules and procedures to manage the default of one or more of its participants ensuring that the CSD can take timely action to contain losses and liquidity pressures and continue to meet its obligations.*
- 2. A CSD shall make its default rules and relevant procedures available to the public.*
- 3. A CSD shall undertake with its participants and other relevant stakeholders periodic testing and review of its default procedures to ensure that they are practical and effective.*
- 4. In order to ensure consistent application of this Article, ESMA may, in close cooperation with the members of the ESCB, issue guidelines in accordance with Article 16 of Regulation (EU) No 1095/2010.*

## Annex II – Cost-benefit analysis

1. Article 41(4) suggests the possibility for ESMA to issue guidelines in order to specify further the default rules and procedures a CSD must have in place to address the default of one of its participants.
2. The choices or options envisaged by ESMA while drafting these guidelines were therefore limited to whether to issue these guidelines or not issuing them.
3. There are directly applicable provisions in the CSDR that would not apply in a uniform, consistent and coherent way within the Union in the absence of a clarification from ESMA on participant default rule and procedures.

	<b>Description</b>
<b>Benefits</b>	<p>These guidelines are aimed at providing clarity by specifying the default rules and procedures a CSD should set up in order to address the default of one of its participants, providing for parties that may be involved, actions that may be taken, and communication that may be organised in respect the treatment of such default.</p> <p>Although the lists provided should not be considered exhaustive and are meant to be indicative, it should assist CSDs for the purposes of complying with the requirements set out in Article 41 of the CSDR. In particular, these guidelines should help bringing more homogeneity in the content and presentation of rules and procedures established by the various CSDs, thus giving more clarity to the participants and their clients as to the consequences of the default of a participant on the client accounts it holds.</p> <p>It should also assist their competent authorities for their monitoring and supervisory activities.</p>
<b>Compliance costs</b> - <b>One-off</b> - <b>On-going</b>	<p>In principle, these guidelines should not burden the CSDs, their participants or competent authorities, as they do not directly set forth any additional requirement (eventual cost of defining participant default procedure and rules and of implementing them are arising directly from the provisions laid down in the CSDR).</p>



## **Annex III – Guidelines on CSD participants default rules and procedures**

### **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.questions@esma.europa.eu](mailto:CSDR.questions@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/EC<sup>2</sup> (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.

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<sup>2</sup> “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.