

## ***Terms of Reference – July 2016***

### **Implementing a new Settlement Discipline Regime in the UK & Ireland**

**Objective:** To ensure that Euroclear UK & Ireland (EUI), LCH.Clearnet, and UK and Irish trading venues and investment firms work together to create and smoothly implement a new Settlement Discipline Regime (SDR) that meets all the requirements of the Central Securities Depositories Regulation (CSDR) within 24 months of the entry into the Official Journal of the settlement discipline technical standards.

#### **Background**

1. The CSDR will require the creation of a new SDR that prevents and addresses settlement fails in the Securities Settlement Systems (SSSs) operated by a CSD. The SSSs of the UK and Ireland are operated by one CSD, EUI. One CCP, LCH.Clearnet, clears securities transactions for the UK. There are multiple trading venues and even more investment firms within scope in both the UK and Irish jurisdictions.
2. The creation and implementation of the SDR will be a complex undertaking as it will involve coordinating these various actors across diverse features. In order to mitigate the project risk involved, these actors must be motivated to work together against a timeframe with clear responsibilities for delivery. The competent authorities of these actors need to work together to ensure that this coordination is effective.

#### **Industry responsibilities**

3. The SDR is formed of two distinct parts – measures to prevent settlement fails (Article 6), and measures to address settlement fails (Article 7). These are supplemented by further technical standards. The following paragraphs set out the high level industry responsibilities according to the level I.

#### ***Measures to prevent settlement fails (Article 6)***

4. **Trading venues** shall establish the confirmation of relevant details of transactions in financial instruments on the date when the transaction has been executed.
5. **Investment firms** authorised under MiFID shall take measures to limit the number of settlement fails through at least prompt communication of the allocation of securities to the transaction, confirmation of the allocation, and confirmation of the acceptance or rejection of terms in good time before the Intended Settlement Date (ISD). ESMA may issue guidelines on standardised procedures and messaging protocols on this.
6. For ***each*** SSS it operates, a **CSD** shall establish procedures that facilitate the settlement of these transactions on the ISD with a minimum exposure of its participants to counterparty and liquidity risks. It shall promote early settlement on the ISD through appropriate mechanisms.
7. For ***each*** SSS it operates, a **CSD** shall put in place measures to encourage and incentivise the timely settlement of transactions by its participants. CSDs shall require participants to settle their transactions on the ISD.

#### ***Measures to address settlement fails (Article 7)***

8. For ***each*** SSS it operates, a **CSD** shall establish a system that monitors settlement fails. It shall provide monthly reports to competent and relevant authorities, including the measures envisaged by **CSDs** and their **participants** to improve settlement efficiency.

9. For **each** SSS it operates, a **CSD** shall establish procedures that facilitate settlement of transactions that are not settled on the ISD. These procedures shall provide for a penalty mechanism which will serve as an effective deterrent for participants that cause settlement fails.
10. Before establishing these procedures, a **CSD** shall consult the relevant **trading venues** and **CCPs** that it provides settlement services to.
11. **CSDs**, **CCPs**, and **trading venues** shall establish procedures that enable them to suspend in consultation with their respective competent authorities, any **participant** that fails consistently and systematically to deliver the financial instruments on the ISD and to disclose to the public its identity only after giving that **participant** the opportunity to submit its observations and provided that the competent authorities of the **CSDs**, **CCPs** and **trading venues**, and of that **participant** have been duly informed.
12. In addition to consulting before any suspension, **CSDs**, **CCPs**, and **trading venues** shall notify, without delay, the respective competent authorities of the suspension of a **participant**.
13. For all transactions cleared by a **CCP**, the **CCP** shall be the entity that executes a buy-in.
14. For transactions not cleared by a **CCP** but executed on a **trading venue**, the **trading venue** shall include in its internal rules an obligation for its **members** and its **participants** to apply the measures to address settlement fails.
15. For all transactions other than those cleared by a **CCP**, or uncleared but executed on a **trading venue**, **CSDs** shall include in their internal rules an obligation for their **participants** to be subject to the settlement discipline measures.
16. A **CSD** shall provide the necessary settlement information to **CCPs** and **trading venues** to enable them to fulfil their settlement discipline obligations.
17. A **CSD** may monitor the execution of buy-ins where executed by a **CCP**, or by **members** or **participants** of a **trading venue**, or by their own **participants** with respect to multiple settlement instructions, on the same financial instruments and with the same date of expiry of the execution period, with the aim of minimising the number of buy-ins to be executed, and the impact on the prices of the relevant financial instruments.

#### **Regulatory responsibilities (Article 8)**

18. The competent authority of the **CSD** that operates the SSS, the relevant authority responsible for the oversight of the SSS concerned as well as the competent authorities for the supervision of the **trading venues**, **investment firms** and **CCPs** shall be responsible for ensuring that the measures to prevent settlement fails and the measures to address settlement fails are applied by the institutions subject to their supervision, and for monitoring the penalties imposed. Where necessary, the respective competent authorities shall cooperate closely.
19. The Bank of England (“the Bank”) is the competent authority with responsibility for UK SSSs, CSDs, and CCPs. The relevant FMIs in this context are CREST, EU1, and LCH.Clearnet.
20. The Financial Conduct Authority (FCA) is responsible for UK trading venues and investment firms authorised under MiFID.
21. The Central Bank of Ireland (CBI) is responsible for the oversight of the Irish SSS, and Irish trading venues and investment firms authorised under MiFID.
22. The Bank, FCA, and CBI therefore comprise the competent authorities responsible for the enforcement of the SDR.

### **Proposed approach**

23. An SDR Standing Group should be set up by the Article 8 competent authorities to help industry to create an SDR that meets all the requirements of the CSDR, and coordinates its smooth implementation within 24 months of the relevant technical standards entering the Official Journal (estimated Q3/4 2018). To do this, the scope of the work should include the level I, level II, and level III requirements and guidelines. The Standing Group should meet at six-weekly intervals.
24. The Standing Group should be chaired by the Bank of England. As the key FMI for the SDR, EUI should be invited to provide a secretariat and facilities. Members of the Standing Group should attend at the invitation of their relevant competent authorities, or at the recommendation of the Chair of the respective MAC.
25. The competent authorities should consider the need for the Standing Group to be representative of the affected community, while keeping the size of the Standing Group manageable. Consideration should also be given to the experience of potential candidates from firms and FMIs, including their ability to handle technical detail while having sufficient seniority to both represent their constituency, and generate the necessary traction for smooth implementation. Consideration should also be given to the role of trade associations in the process where appropriate.
26. The Standing Group should identify the key issues to the creation and implementation of the new SDR, and develop an action plan with clear milestones for delivery, along with a register to monitor identified risks to the implementation of the new regime. The Standing Group should identify specific technical themes to allow for the creation of task forces reporting to Standing Group sponsors that can tackle issues in a tailored way. These task forces should be overseen by the most relevant regulator.
27. The action plan should contain adequate time for consultation on system, contract, and rule changes. Adequate time should also be provided for testing of any technical solutions. The competent authorities should assist with clarification on outstanding questions of the SDR requirements by raising them with either ESMA or the European Commission as appropriate.
28. As part of chairing the Standing Group, the competent authorities should organise a phone conference two weeks before each meeting to review progress since the last meeting and agree the agenda for the forthcoming meeting.

### **Initial invitations to the Standing Group**

#### ***Bank***

1. EUI
2. LCH.Clearnet
3. Chair of the UK Market Advisory Committee (MAC)

**FCA**

4. LSE
5. BATS
6. Bank of New York Mellon
7. State Street
8. Barclays
9. RBS
10. HSBC
11. BlackRock
12. Winterfloods
13. Wealth Management Association
14. Peel Hunt
15. Member of the UK Settlement Bank Committee – Citigroup
16. Member of the UK MAC – BAML
17. Member of the UK MAC – Investec

**CBI**

18. Irish Stock Exchange (ISE)
19. Chair of the Irish MAC
20. Member of the Irish MAC – Computershare
21. Member of the Irish MAC – Davy Group