European Central Securities Depositories Association

Brussels, 8 June 2020

John Berrigan, Director General,
Directorate-General Financial Stability, Financial Services and Capital Markets Union,
European Commission,
Brussels, Belgium

Subject: COVID-19 impact on the implementation timeline of the Settlement Penalties regime under CSD regulation

Dear Mr Berrigan,

The European Central Securities Depositories Association (ECSDA) writes to request a postponement in the implementation of Settlement Discipline Regime (SDR), and Settlement penalties in particular, possibly by one year beyond the date of 1 February 2021.

We acknowledge that the European Commission recently adopted a decision to amend the date of entry into force of the Central Securities Depositaries Delegated Regulation on Settlement Discipline (Regulation 2018/1229). **In this letter, we aim to alert you about a set of new elements which affect the SDR timeline and might not yet have been considered by the Commission.** We hope these elements will be taken into account during the scrutiny period of the amendment.

In the current situation of COVID-19 outbreak, our attention primarily focuses on the safety-related aspects of the processing of financial transactions and delivery of the infrastructure enhancements with limited risks for the market participants.

The COVID-19 pandemic has impacted the overall implementation of regulatory projects and IT deliveries of financial institutions, including CSDs and their participants. In addition to SDR, CSDs and their communities are currently preparing various regulatory mandatory projects, due for implementation between 2020 and 2023. As FMIs, securing daily operational resilience is our priority. During these particular times, ensuring day-to-day operational and cyber resilience has been and remains the prime concern of our national competent authorities. Hence, we see it as our duty to alert the authorities on the different challenges we foresee will have jointly an impact on the SDR implementation timeline and its secure implementation in the market, zooming specifically on the elements that will affect the settlement penalties mechanisms.

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We would like to provide you with an overview of the key considerations that lead us to call for an extended timeline.

A holistic approach to the postponement of interdependent projects is required

As mentioned, CSDs and their communities are preparing the testing and implementation of various parallel regulatory and mandatory projects, which broadly affect the same financial institutions and touch upon the same functional or technical aspects of the financial infrastructure. The projects include cyber risk-related patches, mandatory software upgrades, in some countries change of the CSDs legacy systems, launches of new services and products, as well as the major deliveries required or agreed with the EU or national competent authorities.

The most important milestones and projects relevant to EU post-trade are:

1. The reviewed Shareholder Rights Directive (SRD II) in September 2020,
2. Testing for T2-T2S consolidation as of December 2020,
3. Settlement Discipline Regime in February 2021,
4. Launch of T2-T2S consolidation in November 2021,
5. Eurosystem Collateral Management System (ECMS) testing as of November 2021.

For CSD participants the list might be broader. IT releases are organised in such a way, that each new project builds upon the existing IT environment. Additional elements need to be considered when re-planning development and implementation timelines:

- SWIFT releases in November 2020 and November 2021 which offer mandatory elements for the above-mentioned projects to be delivered,
- Regular T2S releases,
- Eurosystem major infrastructure releases are generally also planned for November,
- Periods during which major implementations are typically avoided (e.g. summer or Christmas holidays),
- Time-lapse required between important launches (at least two to three months).

Considering the complexities and interdependencies among those projects in terms of development, testing and production, we recommended taking a holistic approach when considering a postponement of those projects. This is needed to avoid inconsistencies that will increase the effort for all involved parties, requiring important re-planning and re-work. Indeed, the operational risk embedded into each of those projects – which has been increased by the COVID-19 (as explained below) – will be amplified where the postponement of those projects is not granted consistently among all.

COVID-19 and the accumulation of IT deliverables has led to a bottleneck in the delivery of post-trade IT projects

Financial institutions must implement effective contingency plans in the face of the COVID-19 pandemic. 'Run-the-institution' activities have been reprioritised over 'change-the-institution' activities. The latter are postponed, due to the pressure of COVID-19 on core operations for all projects. As a result, CSDs evidence an accentuation of the bottleneck of regulatory and other IT deliveries for their ecosystems.

Apart from the impacts of COVID-19 outbreak, the implementation plans for the SDR include only the months of December and January for the CSD participants to be able to test the settlement penalties mechanisms. We consider that this is a challenging timeline to test under normal circumstances. Considering the current setting, it will be too short for CSD participants to consider issues and correct and implement the necessary changes. This exacerbates the IT-deliveries bottleneck and further challenges the operational resilience of CSDs' ecosystems.

Some projects and regulatory requirements were postponed or requested to be postponed by one year

We welcome the solidarity expressed by the authorities while accommodating for the delays in the implementation of SFTR, Basel capital requirements and other projects by one year. Besides, SWIFT has recently modified the strategy for ISO20022 cross-border payments postponing it by one year.

ECSDA has supported the request for SRD II postponement by 12 months[1] and acknowledges the need expressed by certain market participants for a deferral for T2 - T2S consolidation[2]. The date of implementation for the ECMS lies further ahead and has not yet been subject to a formal request for postponement, but this may still occur.

We acknowledge the response of DG JUST to the Joint industry letter on SRD II[3]. It is not the purpose of this letter to react to it. Although, in the current circumstances, we believe that operational risk management concerns, as well as the human factor, need to be duly considered by the authorities beyond the legal considerations. Should the SRD II enforceable date be maintained, the operational pressure on the IT and project resources within the CSDs' ecosystems will further increase, leading to a reallocation of resources away from the projects prioritized in these times of crisis and rendering resources for the other projects, and in particular SDR, even scarcer.

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[1] Joint trade association letter on the impact of COVID-19 on the further implementation of the Shareholder Rights Directive II, https://ecsda.eu/archives/12967.
[2] EBF, ESBG, EAPB and EACB Request for delay of T2-T2S consolidation project, https://www.ebf.eu/retail-payments/request-for-delay-of-target2-targe2-securities-consolidation-project-ebfeacb-esbg-and-eapb-joint-letter/
[3] Ares(2020)2773100.

We fear that a fragmented approach might lead to separate postponement decisions across projects. We call upon the Commission (DG FISMA and DG JUST), the co-legislators and the Eurosystem to take a holistic approach on the implementation timeline of these regulatory and mandatory projects. We believe that a holistic approach would greatly alleviate the delivery burden on infrastructures and their ecosystems, also reducing operational and project risks related to a fragmented implementation.

Pending regulatory guidance is needed to finalise market practice

SDR is a very specific regulatory project: it is pan-European by nature, and interpretation issues have been incrementing. As an industry, we remain fully committed to its consistent and timely implementation. However, the amount of work still necessary to be done for the proper implementation of the SDR should not be underestimated. Two years after the issuance of the RTS by the European Commission, there are still outstanding important elements of regulatory and market guidance (mostly in the form of Commission or ESMA Q&As). ECSDA has issued and recently updated its Settlement Fails Penalties Framework[4]. However, it remains still a 'living document' until we achieve legal certainty on the interpretation of regulatory requirements and appropriate ways of compliance, to get clarity on which we asked for guidance. This is hindering the preparation to the completion of the CSDs' SDR-related projects. Delaying the implementation of SDR would allow more time for this much-needed finalisation.

Timeline uncertainty could further aggravate risks. ECSDA calls for the decision on the postponement to be announced quickly.

CSDs are wary of a potential fragmented launch in case the current implementation dates for SDR and other post-trade projects is maintained. In the context when there is no clarity on the regulatory views on the implementation solutions, the sanitary uncertainty is still expected to last for a considerable time, as we do not know the full extension of COVID-19 measures at the EU and Member State levels, particularly if we consider a possible 'second wave'. The impact on productivity caused by confinement will continue to impact CSDs and the market even after the end of confinement. The end of the confinement, on the other hand, will not allow financial institutions to immediately regain full production capacity. There is a risk that the implementation would depend on the circumstances of individual institutions in view of their specific timelines and IT capacity.

[4] The first draft version of the ECSDA CSDR Settlement Fails Penalties Framework was issued in July 2018. The latest version is available on the ECSDA website: https://ecsda.eu/archives/12974.

To allow for a quick re-planning of activities by all actors, we kindly urge the European authorities to decide and announce a revised implementation deadline in the coming weeks. The proposed holistic approach may lead to the postponement of the mentioned projects by one year. Therefore, for the SDR, the activation date could possibly be delayed by one year, to 1 February 2022. We believe that an accommodative regulatory timeline would decrease the risks in post-trade activities of European markets.

Should you have any questions, ECSDA and its members would be pleased to respond to them. We would very much appreciate a possibility to enter into a dialogue with the authorities ahead of their decision.

Mathias Papenfuß
ECSDA Chair

Anna Kulik
ECSDA Secretary-General

Copy to:
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Ms Anamarija Staničić, Head of Policy and International Cooperation Division, Croatian Financial Services Supervisory Authority (Croatian Presidency of the European Council)

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Mr Ulrich Bindseil, Director General of Market Infrastructure and Payments, European Central Bank

Ms Salla Saastamoinen, Acting Director-General for Justice and Consumers, European Commission

Mr Patrick Pearson, Head of Financial Markets Infrastructure, DG FISMA, European Commission

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