

# PROCEDURE IN THE CASE OF INSOLVENCY OF SETTLEMENT PARTICIPANTS [PR420]

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## DOCUMENT VERSIONS

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## 1. INTRODUCTION

Article 41.1 of Regulation (EU) 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 (CSD) (hereinafter, "CSDR"), states that "For each settlement system they operate, the CSDs will have effective and clearly defined rules and procedures to deal with the non-payment of one or several participants and ensure that the CSD can implement timely measures to contain the losses and pressures on liquidity and to continue fulfilling their obligations " Likewise, Article 41.3 establishes that "CSDs will carry out tests and periodic reviews of the non-payment procedures with their participants and other interested parties, in order to ensure that they are feasible and effective".

Title III of the Rules and Regulations of IBERCLEAR governs the regime applicable to settlement participants in the systems managed by IBERCLEAR, establishing in its article 13 IBERCLEAR's actions in the case of the insolvency of a settlement participant, in accordance with the specific provisions included for such case in the general provisions that may be applicable to IBERCLEAR.

In line with this, IBERCLEAR's Circular 5/2017, of 4 September, governs the rules and procedures to address the insolvency of one or several participants, contemplating the performance of tests and the review of the actions set forth therein, as well as the communication systems with the CNMV, Banco de España and settlement participants and any others that may be established, in accordance with the Access or Link Agreement with Central Counterparties and Central Securities Depositories.

## 2. PROCEDURE IN THE CASE OF INSOLVENCY OF A SETTLEMENT PARTICIPANT

This procedure sets out the actions to be taken in the case of an insolvency of a settlement participant in IBERCLEAR, as well as the details of the tests and periodic reviews to be performed, according to the applicable regulation.

The procedure to be followed by IBERCLEAR in such an event comprises the following actions:

- 1) Awareness of the insolvency of the settlement participant and commencement of the procedure
- 2) Application of the rules on finality
- 3) Notification/Publication
- 4) Operational actions
- 5) Other actions

### 2.1. Awareness of the insolvency of the settlement participant

In accordance with the provisions of Law 41/1999, of 12 November, and Law 22/2003, of 9 July, IBERCLEAR will be formally informed of this situation by the Court that has initiated the insolvency proceedings of a settlement participant, the CNMV or Banco de España.

Additionally, IBERCLEAR may be informed of a participant's default by:

- The relevant participant to whom the default concerns, since participants are obliged to inform about any modification or circumstance which may affect its due compliance with its settlement obligations (article 8 or IBERCLEAR's Regulation). This communication needs to be made using the regular communication channels with IBERCLEAR: via email and also via telephone call<sup>1</sup>.
- A central counterparty (hereinafter, CCP), regulated market, multilateral trading facility or Central Securities Depository (hereinafter, CSD) under the linked agreement or access agreement signed by those financial market infrastructures with IBERCLEAR.
- A Central Bank (hereinafter, NCB) or CSD that uses TARGET2-Securities (hereinafter, T2S) who has been informed of the insolvency of a participant and makes this information available to all other central banks and central securities depositories' users of T2S through T2S in accordance to its procedures.
- Any other person with knowledge of the existence of the default

In all these cases, IBERCLEAR shall verify with the CNMV the accuracy of the information received prior to initiating any of the actions detailed below.

As soon as IBERCLEAR is informed of a default of a participant, it will transmit this information to the CNMV, along with all the available details on the defaulting situation and the source of the information.

## 2.2. Application of the rules on finality

Once the insolvency notification has been received and its accuracy has been verified, IBERCLEAR will proceed to establish the following restrictions in the ARCO System, no matter the case:

- 1.- Blocking the settlement of transfer orders, with the exception of trades that involve the return of the securities contributed as collateral to a Central Bank of the Eurosystem and that still remain pending settlement.
- 2.- Blocking the entry of new transfer orders of the participant subject to the insolvency proceedings that involve a debit to the securities account or the DCA of the insolvent participant.

In the event that the insolvent participant was a DCP, the privileges that said participant would have on the securities accounts or any others that had been granted by third parties will be revoked.

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<sup>1</sup> Email address to be used is [entidadesiberclear@grupobme.es](mailto:entidadesiberclear@grupobme.es)

### 2.3. Notification and publication

IBERCLEAR will use an Informative Memo to make the defaulting situation known across the market. This Informative Memo will be sent to its participants, the CNMV (which has been informed on a bilateral basis in advance), Banco de España, the regulated markets, multilateral trading facilities, CCPs and CSDs with which IBERCLEAR has signed contracts or established links. This notification will be made by Informative Memo. IBERCLEAR will also be able to use the messaging systems that it normally uses, and may include information on the actions carried out or to be carried out in accordance with the present procedure.

In addition, IBERCLEAR must make this information available to the NCBs and CSDs that use T2S, doing so through the procedures established for that purpose in T2S.

### 2.4. Operational actions

During an insolvency proceeding, the transfer orders of the participant can be found in any of the following situations, and the procedure indicated for each one must be followed:

Situation	Description
1	Transfer orders entered before the opening of insolvency proceedings.
2	Transfer orders entered after the opening of insolvency proceedings, which were matched on the T2S platform before the CSD/NCB becomes aware and for settlement on the same business day.
3	Transfer orders entered after the opening of insolvency proceedings, which were matched on the T2S platform before the CSD/NCB becomes aware but for settlement later than on the day of insolvency.
4	Transfer orders entered after the opening of insolvency proceedings, which were not matched on the T2S platform by the time the CSD/NCB becomes aware.
5	Transfer orders entered after the moment the CSD/NCB becomes aware of insolvency proceedings upon request of the insolvency liquidator.
6	Transfer orders entered after the moment the CSD/NCB becomes aware of insolvency proceedings without involvement of the insolvency liquidator.

Therefore, once the technical restrictions have been established, IBERCLEAR will carry out the following actions (jointly when appropriate) with the T2S Operator:

- 1.- Identification of transfer orders affected by the insolvency of the settlement participant, including type of transactions and financial instruments those orders are related to, and information on the time of entry (SF1) and irrevocability (SF2) of each one.

To do this, a query will be made and the information obtained will be downloaded into a file that allows each transfer order to be classified into the scenario that is applicable according to the information obtained. Likewise, a complete list may be requested from the T2S Operator.

- 2.- Identification of the volume and values of the pending settlement instructions. This information will be extracted from the same report as that mentioned in the previous point.
- 3.- Identification and analysis of the impact of the participant's insolvency on the particular conditions of its participation and its possible impact on other settlement participants in the system: delegated entity, DCA, and securities accounts of the participant in insolvency proceedings.
- 4.- Participation in the coordination meetings that may be called within the scope of T2S (teleconferences of *Settlement Managers* to ensure that all CSDs and Central Banks are coordinated).

As a result from the aforementioned actions IBERCLEAR will, as soon as possible, inform the CNMV of the relevant information described below, as well as the actions to be taken and the orders related to the declaration of insolvency:

- Information on the defaulting participant, including 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.
- The type of transactions and financial instruments those instructions relate to.
- When applicable, in which common IT settlement infrastructure (i.e.: T2S) the defaulting participant's settlement instructions are processed and, when available, any other indicators of cross border activities of the participant in default.
- Number of clients the defaulting participant has, if this information is known to IBERCLEAR.
- Information on any material risk that such default might entail.

IBERCLEAR will also notify the defaulting participant of the actions to be taken and the trades related to the declaration of insolvency.

IBERCLEAR will carry out the following activities in relation to the transfer orders affected by the insolvency of the settlement participant:

- 1.- Firstly, and after the establishment of the restrictions, the transfer orders of the participant subject to the insolvency proceedings that involve a debit to the securities account or a debit to the DCA of said participant and which were sent to the ARCO System after the moment in which the CSD/NCB became aware of the proceedings without the involvement of the liquidator of the procedure, will be automatically rejected.
- 2.- Process the transfer orders that were entered on the ARCO System before the insolvency procedure of the entity was initiated according to the rules of the settlement system.
- 3.- In the case of transfer orders that have been entered in the ARCO System after the insolvency proceedings of the entity have been initiated and that had already been matched on the T2S technical platform before the CSD/NCB was aware of the procedure and that have a theoretical value date that is the same day as the insolvency and that involve a debit to the securities account of the participant object of the insolvency or a debit to the DCA of said participant, these will be processed according to the rules of the settlement system until the end of the day, at which time those that have not been settled will be cancelled.
- 4.- In the case of transfer orders that have been entered in the ARCO System after the insolvency proceedings of the entity have been initiated and that had already been matched on the T2S technical platform before the CSD/NCB was aware of the proceedings and that have a theoretical value date that is the day after the insolvency date and that involve a debit to the securities account of the participant object of the insolvency or a debit to the DCA of said participant, shall be immediately held for their subsequent cancellation.
- 5.- Cancel the transfer orders that were entered on the ARCO System after the initiation of the insolvency proceedings and that were not matched on the T2S Technical Platform at the time when the CSD/NCB was aware of the proceedings and involve a debit to the securities account of the participant object of the insolvency or a debit to the DCA of said participant.
- 6.- Process, according to the rules of the settlement system, the transfer orders that were entered on the ARCO System after the CSD/NCB was aware of the proceedings, at the request of the liquidator.

Once the activities described in the previous points have been completed and verified, the settlement restrictions will be deactivated, and subsequently the instructions that remain in the system and require settlement will be allowed to attempt to settle.

The restriction of the entry of transfer orders will remain in force until the Court establishes the end of the procedure.

As soon as possible, IBERCLEAR will inform of the actions taken following the default situation to Banco de España, ESMA<sup>2</sup>, its non-defaulting participants, the trading venues and CCPs with which IBERCLEAR has signed an access, T2S and the CSDs with which IBERCLEAR has established a link.

All the actions described in the procedure and carried out in T2S will be performed allowing the operational management in a coordinated manner with the rest of the CSDs and NCBs of T2S.

## 2.5. Other actions

IBERCLEAR will act in accordance with the special provisions set forth in article 15 and article 102 of the Consolidated Text of the Securities Market Act, taking into account the instructions that may be received from the bankruptcy judge and from the CNMV.

## 3. PERIODIC REVIEW OF THE PROCEDURES IN THE CASE OF INSOLVENCY OF SETTLEMENT PARTICIPANTS

The procedure described is intended to be carried out in the event of a contingency of great significance for the stability of the system and, therefore, it must be tested at least on an annual basis and, in any case, following any substantial changes to IBERCLEAR default rules and procedures or upon request from the CNMV, to ensure that when its application is needed it can be carried out with maximum efficiency and obtain the expected results after its application.

These periodic tests will be carried out once a year within the calendar of operational tests agreed within T2S. The tests will be carried out in the IBERCLEAR testing environment

One relevant point highlighted in the CSD participants default rules and procedures guidelines issued by ESMA, is that a CSD should involve any relevant stakeholders in the annual tests. Following such guidelines, and despite giving to all entities the opportunity to participate in the test, IBERCLEAR will control that the final number of participants represent, at least, 80% of the day to day settlement activity.

Whenever tests are carried out of the actions contained in a real procedure, the same structure followed in said procedure will be followed. Thus, the phases of said testing procedure will be:

- 1) Previous actions for defining the test
- 2) Execution of the test
- 3) Report on test outcome

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<sup>2</sup> Making use of the email address [csdr.notifications@esma.europa.eu](mailto:csdr.notifications@esma.europa.eu)

The testing activities to be performed by the participants are detailed in the “Test guidelines” (section 3.4).

### **3.1. Previous actions for defining the test**

The establishment of the exact date of the performance of the test will be decided by IBERCLEAR after consulting with T2S, the CNMV and Banco de España. Once this decision has been made, IBERCLEAR will inform all parties involved in the tests by means of an Informative Memo. This Informative Memo will be published sufficiently in advance of the date established for the commencement of the tests.

After the publication of the date of the test, IBERCLEAR will contact several stakeholders to confirm their availability and get their commitment to participate in the test. Following such contacts, and in order to guarantee the 80% threshold of participation mentioned in the previous section above, IBERCLEAR will collect written confirmation of participation from all the Key participants of IBERCLEAR, and at least one representative of the following relevant market infrastructures: CSD, CCP and trading venues. Within this scope of participants, the requirements of variety in terms of profile of business, type of accounts and country zones are met. In the hypothetical case that the 80% threshold is not achieved, IBERCLEAR will contact the next tiers of stakeholders in order to guarantee the level of participation aimed.

The insolvent participant will be a fictitious entity that IBERCLEAR has created in said environment. Its account structure will be configured depending on the situation that requires testing. IBERCLEAR participants will be requested to participate through an Informative Memo, in which the specific data needed to participate efficiently in the aforementioned test will be detailed.

Within the framework of tests, on the date announced for the performance of tests and reviews, IBERCLEAR will apply the rules on finality as established in Law 41/1999 and in its own Rules and Regulations to the settlement participant allegedly declared insolvent. Likewise, and always within this test scenario, IBERCLEAR will apply, if necessary, the rules on the transfer of securities and the pro rata rule provided for in article 15 of the Consolidated Text of the Securities Market Act, as well as the applicable rules in the case of insolvency of a settlement participant in a central securities depository, as provided for in article 102 of said legal text, to the trades and settlement instructions of the fictitious participant considered to be in insolvency proceedings.

In this test scenario, the CNMV will be able to make use of its power to arrange the transfer of the book-entry registers of the securities of the allegedly insolvent participant to another participant authorised to carry out this activity.

Within this test framework, all the participants will be obliged to adhere to the requirements of the CNMV and IBERCLEAR within the shortest possible periods.

In addition, IBERCLEAR will carry out a series of activities prior to the execution of the test, necessary for its execution:

- Creation of the configuration of the fictitious insolvent participant.
- Communication to the T2S Operator of the information detailed in the previous point.
- Verification and monitoring so that the settlement participants participate by carrying out the requested activities described in the Informative Memo.
- Instructions will be sent on behalf of the insolvent fictitious entity, in order to match a number of instructions, with the aim of obtaining the necessary situation for the test.

## 3.2. Execution of the test

### 3.2.1. Situation to be tested

The necessary verifications must be carried out during the test to verify the correct operational functioning in all the situations described above. Therefore, at least all the scenarios in which the transfer orders can be found under the insolvency assumption must be configured and tested.

### 3.2.2. Actions to be performed during the test

The testing procedure will begin on the previously established date and time, on the basis that IBERCLEAR is the first one to become aware of the situation of insolvency. The first action will be the disclosure of the situation generated by the insolvency. This must be done through the immediate communication, by IBERCLEAR, to its participants, CNMV, Banco de España, regulated markets, multilateral trading facilities, CCPs and CSDs with which IBERCLEAR has signed contracts or established links.

In addition, at the agreed time, a teleconference will be held among the *Settlement Managers* in which each of the CSDs/NCBs that are in T2S will report on the situation they wish to perform tests.

In this test procedure, IBERCLEAR will notify them all of the insolvency of a settlement participant and the actions undertaken as indicated throughout this procedure. This notification will be made via the Informative Memo; the messaging systems normally used by IBERCLEAR can also be used.

With regard to the notifications through T2S, IBERCLEAR may also use the channels designed for this purpose in said technical support, to send notifications with the same content and clearly specifying that it is a test procedure.

Actions on the day of the test:

- 1.- The restrictions on the T2S Technical Platform will be activated to prevent the settlement involving the securities accounts of the insolvent participant.
- 2.- The restrictions will be activated to prevent the entry of settlement instructions on the securities accounts of the insolvent participant and which represent a debit to said accounts.
- 3.- In the event that the insolvent participant was a DCP, the privileges that said participant would have on the securities accounts or any others that had been granted by third parties will be revoked.
- 4.- Instructions will be sent on behalf of the insolvent participant in order to verify the correct functioning of the established restrictions.
- 5.- It will identify the pending instructions of the insolvent participant which have reached the finality stages (SF1 and SF2), throughout a query to T2S. Moreover, a list of transactions will be requested from the T2S Operator.
- 6.- These transactions will be assigned to the cases, in order to identify each applicable scenario.
- 7.- The pertinent actions will be carried out according to the previously mentioned situation.
- 8.- After the execution of the action, a file will be downloaded with the pending instructions that will need to have the appropriate status, according to the aforementioned situation.
- 9.- It shall encourage the sending of instructions by the participant, to verify that the adequate results are given, as commented.
- 10.- The CNMV will be informed of the relevant information built in paragraph 2.4 of this procedure.
- 11.- Lastly, the moment at which the instructions remaining on the system are allowed to be settled will be decided.
- 12.- Once the actions have been concluded and verified, inform the T2S Operator to deactivate the settlement restrictions.
- 13.- The restriction on the entry of instructions will remain activated until the end of the day, and, therefore, the test.

### 3.3. Reporting on test outcome

After the conclusion of all the actions described in the previous section, IBERCLEAR will prepare a report detailing the scenarios tested, as well as the number and amount of the instructions affected in each one. In said report there will be an assessment of the test both in terms of IBERCLEAR's actions and the participation of the participants as well as a list of the lessons learned after its completion.

Results of the insolvency test and modification in the procedures will be shared within IBERCLEAR Departments. They will also be shared with the CNMV and Banco de España. Additionally, a summary of the results of the test and any change to the internal default procedures will be shared with its participants.

Whether a test reveals a weakness in the process, IBERCLEAR will review the procedure and will make the corresponding modifications. Also, if the test exposes a lack of knowledge or readiness to apply the default rules by a participant, IBERCLEAR will inform the participant and explain the procedure so that the participant is encouraged to follow the procedures. If no corrective measure is taken, IBERCLEAR may reconsider the participation of the entity in the ARCO System

### 3.4. Test guidelines

#### *3.4.1. Activities to be performed by IBERCLEAR*

At [time] on XX of xxxx [date] IBERCLEAR will simulate the receipt of a notification of the declaration of the insolvency proceedings of the settlement participant (moment of the commencement of the insolvency proceedings), as well as the notification of the receipt thereof to the CSDs and NCBs that uses T2S, its participants, CNMV, Banco de España, regulated markets, multilateral trading facilities, CCPs and CSDs with which IBERCLEAR has signed contracts or established links.

Once said notification is received, IBERCLEAR will establish the necessary restrictions on the ARCO System to block the settlement of transfer orders and the communication of new transfer orders from the entity object of the insolvency proceedings.

Once the technical restrictions have been established, IBERCLEAR will carry out the actions aimed at:

- 1.- Identify transfer orders affected by the insolvency of the settlement participant and information on the time of entry and irrevocability of the same.
- 2.- Identify the volume and values of the pending settlement instructions.
- 3.- Identify and analyze the impact of the insolvency of the participant on the particular conditions of its participation and its possible impact on other settlement participants on the system: delegated entity, DCA, and securities accounts of the participant in insolvency proceedings.

4.- Participate in the coordination meetings that may be held within the scope of T2S.

5.- Adopt the instructions received by the CNMV and the court or liquidating authority.

IBERCLEAR will inform the CNMV of the relevant information resulting from the aforementioned actions.

Subsequently, IBERCLEAR will carry out the following actions in relation to the transfer orders affected by the insolvency of the settlement participant:

- Process the transfer orders that were entered on the ARCO System before the insolvency procedure of the entity was initiated according to the rules of the settlement system.
- Cancel the transfer orders that have been entered on the ARCO System after the commencement of the insolvency proceedings and that involve a debit to the securities account of the participant object of the insolvency or a debit to the DCA of said participant.
- The settlement blocking will be deactivated once the activities described in the two previous points have been completed.
- As part of the test, IBERCLEAR will inform the competent authorities of the trades affected by the declaration of insolvency.

### *3.4.2. Activities to be performed by the settlement participants*

Participants are asked to participate in this test as follows:

1.- As of the time of publication of this Informative Memo, up to the [date], they should send settlement instructions of a different type with the settlement participant to be declared insolvent as the counterparty, with intended settlement dates prior to, equal to and after the [date].

The unmatched settlement instructions on [date], will be matched by IBERCLEAR, acting as the insolvent settlement participant.

2.- They shall send transfer orders that involve a debit to the securities account of the insolvent participant or a debit to the Dedicated Cash Account linked to said securities account, which will be rejected due to the restrictions established by IBERCLEAR if they are sent after the establishment of said restrictions, or they will be unilaterally cancelled by IBERCLEAR if said transfers have been sent before said restriction has been activated and after the declaration of insolvency (XX.XX am/pm on [date]).

- 3.- They shall send transfer orders that involve a credit to the securities account of the insolvent participant or a credit to the Dedicated Cash Account linked to said securities account, and which do not represent in any case a debit to the aforementioned accounts, which will be accepted by the system.

The settlement participants will receive the messages corresponding to the instructions sent and the result of the actions carried out by IBERCLEAR on said settlement instructions in the performance of the test.