

CSDR: Central Securities Depository Regulation

Background

The aim of Central Securities Depository Regulation (CSDR) is to harmonise certain aspects of the settlement cycle and settlement discipline and to provide a set of common requirements for Central Securities Depositories (CSDs) operating securities settlement systems across the European Union (EU).

It aims to:

- Increase the safety and efficiency of securities settlement and settlement infrastructures in the EU
- Harmonise the way CSDs across EU operate
- Enhance the legal and operational conditions for cross-border settlement

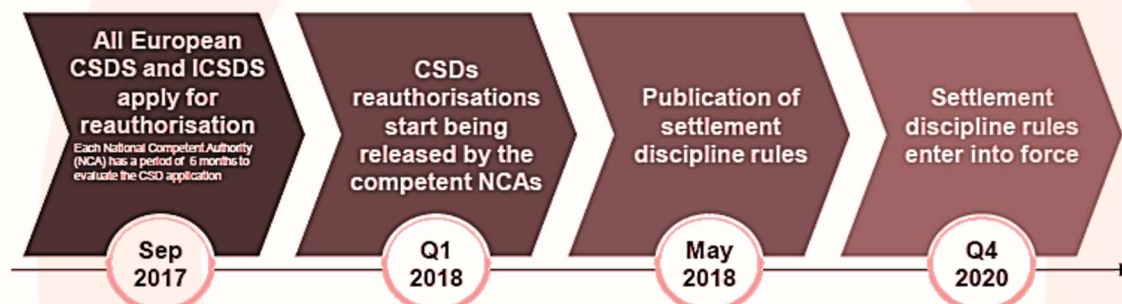
Who will be affected?

The CSDR applies to all European CSDs and to all market operators in the context of securities settlement. Trading parties, central counterparties (CCPs), clearing & settlement agents (which are members of the CCPs and CSDs) and trading venues will also be impacted and will have to directly comply with some of the measures, in particular the introduction of mandatory buy-in regime and cash penalties for settlement failures.

Key Requirements

- Extended CSD Requirements
 - Record keeping
 - Reconciliation
 - Account segregation
 - Participants default rules
 - Operational risk
 - Ancillary banking services
- Internalised Settlement Reporting
 - Reporting entity and content
- Settlement Discipline
 - Preventing settlement fails
 - Monitoring settlement fails
 - Addressing settlement fails – penalties
 - Addressing mandatory buy-ins

Expected Time Frame for Financial Institutions



The new CSD requirements will be effective from the authorisation date for the CSD.

July 2019: Internalised Settlement Reporting

September 2020: entry into force of settlement discipline rules

January 2023: any new security shall be issued in book entry

January 2025: all securities shall be in book entry

CSDs Obligations

Reconciliation: CSDs will be required to suspend settlement when a reconciliation break reflects an undue creation or deletion of securities that cannot be resolved within 24 hours. The aim of this rule is to minimize the risk.

Operational Risk: These requirements impose to identify CSD's key participants and, potentially, the underlying clients of those key participants.

Banking-Type Ancillary Services: CSDR sets out a new prudential framework to govern CSD banking type ancillary services, such as certain cash credit and payment services, CSDs wishing to provide such banking services need to obtain an additional authorisation, which will be subject to a more intensive supervisory regime than today. (Ex: Euroclear SA)

CSD Customer Obligations

Account Segregation: CSDR requires all CSDs to segregate the securities accounts maintained for each participant and offer, upon request, further segregation of the accounts of the participants' clients. This requirement entails for CSDs to maintain records and accounts that enable a participant to hold, in their books, securities separately from other participants and from any proprietary assets the CSD itself may hold. Additionally, CSD customers will need to offer their own clients the choice between omnibus client segregation and individual client segregation.

Internalised Settlement Reporting: Reporting requirements apply to CSD customers' transactions that are settled outside of securities settlement systems. Customers will have to report the volume and value of all such securities transactions on a quarterly basis to their National Competent Authorities.

Book-Entry Form: Any issuer established in the EU that issues or has issued transferable securities, which are admitted to trading or traded on trading venues, is required to arrange for such securities to be represented in book-entry form.

Daily Reconciliation Process: Customers will need to reconcile their records with the information received by the CSD on a daily basis and will need to provide the CSD with all information deemed necessary to ensure the integrity of the issue and to solve any reconciliation breaks.

Use of Legal Entity Identifiers (LEIs): CSD customers, including issuers, will have to supply their CSDs with LEIs – unique 20-character codes that identify their legal entities, which CSDs will record and report to their National Competent Authorities.

Settlement Discipline Rules

Preventing Settlement Fails: CSDs are required to harmonise mandatory matching fields and counter value matching tolerance levels for against payment instruction settlements, in order to introduce a bilateral cancellation facility, a hold and release mechanism and partial settlement.

Monitoring Settlement Fails: CSDs need to monitor the number and value of settlement fails for every intended settlement date, and will need to report the settlement fails and measures to improve settlement efficiency to their respective National Competent Authorities. CSDs will also publish fails data in an aggregated form.

Addressing Settlement Fails: CSD customers will be subject to cash penalties calculated and applied by the CSD for each settlement instruction that fails to settle. The cash will be redistributed to the receiving CSD customer that suffered from the settlement fail. Cash penalty rates are currently set to be as in a table regarding the type of fail.

Addressing Mandatory Buy-ins: CCPs or trading parties will take responsibility for buy-ins by initiating a buy-in auction or appointing a buy-in agent (in the case of a non-cleared trading venue and OTC transactions). CSDs must report the buy-ins to the National Competent Authorities based on information received from the trading parties, trading venue members or CCPs in the case of cleared trades. The time period after which the buy-in process kicks in is determined by asset type and liquidity of the security.

Transactions in scope of mandatory buy-ins (and settlement fails penalties) are:

- All matched settlement instructions in financial instruments as long as they are admitted to trading on a trading venue
- CCP-cleared transactions

A mandatory application of partial settlement will be introduced for clearing members, trading venue members or trading parties: On the last business day of the extension period, some of the relevant financial instruments are available for delivery to the receiving CSD customer, the instruction is not put "on hold" and the partial functionality will be offered by the CSD.

CSDR and TARGET2-Securities (T2S)

Many of the CSDR technical settlement standards mirror those required for T2S, in particular those relating to the settlement functionalities a CSD must offer. The ECB has set up a T2S CSDR Task Force. This task force is analysing the CSDR requirements either impacting T2S functionalities or requiring new T2S functionalities.

Challenges

CSDR promises to bring changes and challenges to the post trade lifecycle and set the foundations for greater settlement efficiency and therefore investor safety.

One of the big challenge is to define a new market practise on how to deal with buy-ins going forward. With buy-ins impacting not only the trading parties, a dialogue is required to also include trading venues, CCPs (for the cleared transactions) and CSDs (for the reporting).

Resolving data sourcing and reconciliation challenges will be particularly important in successfully meeting CSDR obligations.

How can i-Fihn Consulting help you?

Based on several experiences in the implementation of regulatory requirements and many complex reporting projects, i-Fihn Consulting has developed an analysis methodology that enables us to establish new requirements and optimizations efficiently. In addition, our post trade experts will also help you design and implement your business strategy and support your reorganization in light of this new environment.

i-Fihn Consulting recommends that firms should spend time analysing their operational processes to identify why settlements fail and find remedies. The review should include all processes post the execution of a transaction on an exchange or with a broker. In addition, a strategy and implementation plan has to be adapted for complex reporting processes.

We hope you find this document useful in answering most, if not all, of them and we encourage you to reach out to i-Fihn Consulting Business Unit Clearing & Post Trade Activities:

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