

CSDR CENTRAL SECURITIES DEPOSITORIES REGULATION

SOCIETE GENERALE GLOBAL MARKETS
ANSWERS YOUR QUESTIONS ABOUT
THE SETTLEMENT DISCIPLINE REGIME

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TABLE OF CONTENTS

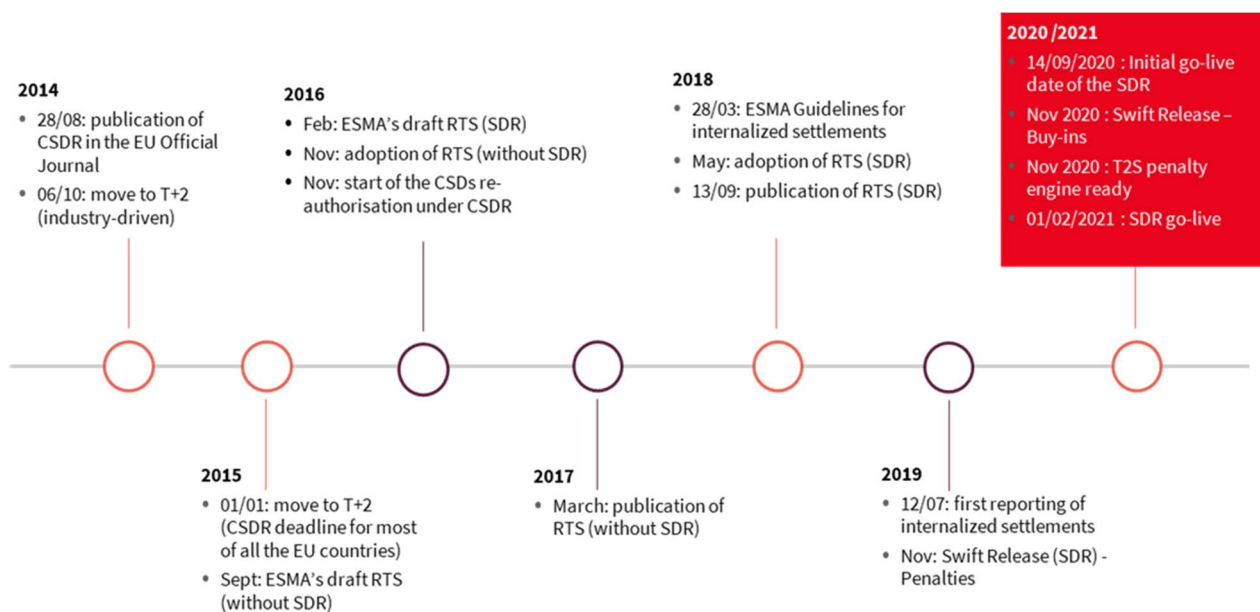
SUMMARY	3
1. SETTLEMENT DISCIPLINE REGIME PRINCIPLES	5
1. Settlement fails prevention	5
a. Confirmation and allocation process	5
b. Matching and population of settlement instructions	5
c. CSD functionalities to assist matching and settlement	6
2. Cash Penalties	6
3. Mandatory Buy-Ins	7
2. IMPROVED SETTLEMENT PRACTICES	9
3. CASH PENALTIES	10
4. MANDATORY BUY-INS	12
5. CONTRACTUAL FRAMEWORK / SLA	13
GLOSSARY	15


SUMMARY

The aim of this document is to inform our clients and their outsourcers of the impacts of the Settlement Discipline Regime (SDR), the next component of the Central Securities Depositories Regulation to come into effect.

After adoption by the European Commission, on May 8th 2020, of an amendment to the Delegated Regulation (EU) 2018/1229 (RTS on settlement discipline), it is **now expected that the SDR will be applicable from February 1st 2021**. Société Générale Global Markets is actively preparing for this deadline.

The document is primarily intended to help your middle and back-office teams to get ready for the introduction of the SDR but can also be of interest to a wider audience.



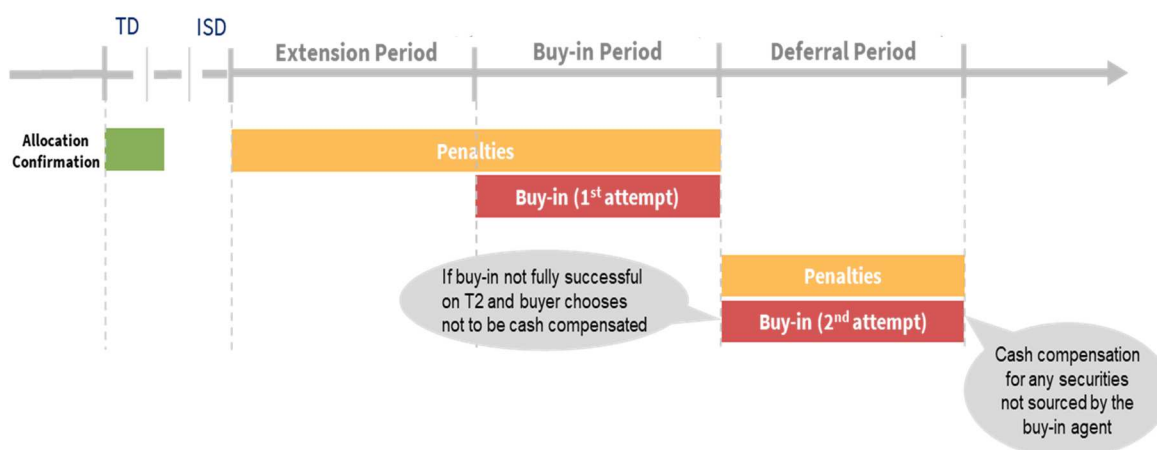
A Newton's cradle with five silver spheres is shown in a shallow depth of field against a light blue background. The sphere in the foreground is in sharp focus, while the others are blurred.

FREQUENTLY ASKED QUESTIONS

1.SETTLEMENT DISCIPLINE REGIME PRINCIPLES

- **Can you briefly describe the main principles of the SDR?**

With the introduction of the Settlement Discipline Regime, a settlement instruction will be either settled or cancelled after a pre-defined period.



1. Settlement fails prevention

a. Confirmation and allocation process

To prevent settlement fails, the regulation introduces new rules related to the communication between the investment firm and its professional clients.

Once the confirmation of the trade execution has been sent by the investment firm:

- The professional client is obliged to confirm its acceptance of the terms of the transaction
- The professional client must also send specific details about the allocation of securities and/or cash
- The investment firm shall confirm the receipt within 2 hours
- The investment firm must offer to its clients the option to send the confirmation and allocation messages electronically using international communication standards.

b. Matching and population of settlement instructions

The regulation requires CSDs to provide to participants with fully automated, continuous real-time matching of settlement instructions.

To facilitate this process, CSDs will then require their participants to populate additional fields in their settlement instructions such as:

- **Transaction type field:** The Type of Settlement Transaction Indicator (SETR) on SWIFT settlement instruction messages (22F)
- **Place of Trade and Place of Clearing:** The Place of Trade will be used to apply the correct cash penalty rate for the relevant financial instrument for Small Medium Enterprise (SME) growth markets. If clients do not notify this, then they may be subject to receive a higher cash penalty. The Place of Clearing will be used to identify if the transaction was cleared through a central counterparty (CCP).

c. CSD functionalities to assist matching and settlement

The Regulation imposes new functionalities to be proposed by EEA CSDs:

- **Standardised settlement matching tolerances of:**
 - 2 Euros for amount transactions < 100 000 Euros (or currency equivalent)
 - 25 Euros for amount transactions > 100 000 Euros
- **Bilateral cancellation** facilities to allow participants to bilaterally cancel matched settlement instructions
- **Hold and release mechanism** to facilitate blocking pending instructions from settling, as well as the capability to release pending settlement instructions that are blocked and therefore allowing them to settle. The regulation also requires Failing Trading Parties to use the hold-and-release mechanism when the settlement instructions are subject to buy-ins.

For additional information on these CSD new services, please refer to your respective custodians or specific CSDs (in case you are a direct participant).

2. Cash Penalties

Penalties will be applied to any settlement instruction that is **not fully settled on its Intended Settlement Date** (ISD) :

- Penalties will be calculated by CSDs at the end of each business day as a percentage of the market value of the financial instrument.

- The rate will depend on the type of financial instrument or the currency.
- The reference price of an instrument should be the same whatever the CSD so that the calculation should be identical for all CSDs.
- The penalty incurred by the CSD participant responsible for the fail will be fully given to its counterparty

Where settlement instructions have been matched after the ISD, penalties will be applied for the period between the ISD and the business day prior to the day on which matching has taken place. In this case of “late matching”, penalties shall be paid by the last participant who entered or modified their settlement instruction in the securities settlement system. It refers to **Late Matching Fail Penalty (LMFP)**.

After matching, the party responsible for the fail is subject to the penalty: this can be the seller lacking securities, the buyer lacking cash or either party having put their instruction on hold. It refers to the **Settlement Fail Penalty (SEFP)**.

Penalties are **calculated daily** by the CSDs and **charged monthly** to their participants (on the 17th business day for all penalties incurred during the previous month).

3. Mandatory Buy-Ins

CSDR considers that failing settlements cannot remain endlessly in this state, even if subject to penalties. Therefore, CSDR introduces a mandatory buy-in process aiming to **close the outstanding settlements** after a pre-defined period of time :

- 4 business days after ISD for liquid shares,
- 7 business days after ISD for other instruments,
- unless the transaction was executed on a SME (Small and Medium-sized Enterprises) Growth Market (as defined in MIFID2/MIFIR), in which case it may be up to 15 business days

The buy-in shall **be initiated by the buyer against the seller** (meaning at transaction level and not at settlement instruction level as is the case for penalties).

However, it is worth noting that:

- in the case of trades cleared by a CCP, the CCP will continue to take care of the buy-ins,

- in the case of trades handled on a trading venue with no CCP, the buying broker will have to initiate the buy-in,
- in all other cases, the buying party will be in charge of the buy-in.

It shall take place at the end of the so-called extension period:

- **The buyer will appoint a buy-in agent** to buy the missing securities. The costs related to this purchase will be borne by the seller.
- A **cash compensation** procedure will be used should the buy-in agent be unable to source the securities.
- The buy-in obligation applies to all failing settlements (including OTC ones), and thus goes beyond the current buy-in process triggered by CCPs against failing clearing members.

Trade Associations across the EU are working together in order to build market practices to operate buy-ins. At this stage, several critical questions remain open.

- **Which entities could be in the scope of the SDR?**

All parties in a securities settlement chain which settle on EEA CSDs will be impacted, including non-European Trading Parties or participants not located in Europe.

Despite the UK's announcement that SDR will not apply to the UK, UK firms who are part of a settlement chain settling on an EEA CSD will be indirectly impacted by SDR.

- **What is the timeframe for the implementation of the SDR?**

On 8th May 2020 the European Commission has published, an amendment to the Delegated Regulation (EU) 2018/1229 (RTS on settlement discipline) setting the **implementation date on February 1st, 2021**¹

¹ https://ecsd.eu/wp-content/uploads/2020/06/2020_06_08_ECSDA_Letter_to_the_EC_on_the_SDR_Postponement.pdf

2. IMPROVED SETTLEMENT PRACTICES

- **Do you foresee any changes or enhancements to your confirmation and allocation process (Art. 2 of RTS 2018/1229)?**

Société Générale Global Markets is providing electronic confirmations via Omgeo CTM, FIX, Traiana and SWIFT.

We believe these methods allow for the exchange of information within the timeframes as specified in the regulation.

- **What is Société Générale Global Markets strategy to better manage inventory (bonds & equities) to ensure delivery on value date**

Prior to SDR, Société Générale Global Markets embarked on an ambitious IT transformation program of their back office information system.

Société Générale has also launched several initiatives around the streamlining of process (e.g. SG won an award at the last Symphony hackathon for a Buy-in workflow developed on their platform).

Société Générale Global Markets also launched several initiatives based on A.I predictive technology to better anticipate and tackle settlement issues before ISD.

Those are few of the many different initiatives which improved the overall settlement rates across Société Générale Global Markets.

As soon as SDR comes into force, it will enhance the failed instructions rate average for the whole market.

Société Générale Global Markets will benefit from this positive general impact.

- **What is Société Générale Global Markets' view of Partial Settlement ?**

Société Générale Global Markets agrees that partial settlement needs to be widely adopted at scale in the market.

Partial settlements would minimize CSD penalties as the penalty calculation basis would be limited to the remaining failed quantity.

Despite that, in specific cases, some penalty asymmetry could occur.

As some CSDs propose a default partial rule to be applied there are ongoing internal discussions to decide whether to validate this option.

- **What IT solutions will Société Générale Global Markets use to assist with SDR?**

Société Générale Global Markets will adapt its IT tools to meet the new SDR processes:

- Position and Instructions systems through its large IT program
- Instructions processing systems for SWIFT MT54X messages updates, to enrich information to give to our Custodian and CSDs
- SWIFT messages to enhance or to extend the use of:
 - MT537 reception/integration from our Custodian and CSDs (where we are direct participants)
 - MT530 emission for buy-ins operations (on hold instructions / buy-in results to CSDs)
- **What preventative actions should I take between now and the implementation of SDR to mitigate fail risk?**

We would suggest different actions to our clients to prepare for the SDR's entry into force:

- Analyse and optimize third-party (clients, brokers...) static data management processes in particular exchange SSIs process
- If possible, enhance, STP workflows through analysis of actual STP rates and identify roadblocks for timely and accurate processing
- Enhance position management through analysis of current settlement efficiency rates
- Identify failing counterparties/ clients, identify root cause and try to reduce existing failed instructions volumes.

3. CASH PENALTIES

- **What is the scope of Instruments eligible to penalties?**

The penalties will be applied to failing instructions regarding the transfer of the following:

- **CSD-eligible MiFID II/ MiFIR transferable securities, money market instruments, units in collective investment undertakings, emissions allowances** which are **intended to be settled on an EEA CSD** and:
 - admitted to trading or traded on an EU trading venue (see ESMA FIRDS databases²); or
 - cleared (or eligible for clearing) by an EU CCP.
- **Excluding shares where the principal trading venue is located in a third country³.**

² https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_firds

³ https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_mifid_shsexs

- **In which currency are penalties going to be collected/distributed?**

Penalties will be calculated by CSDs in multiple currencies corresponding to the cash currency of instruction.

We would advise you to check with your Custodians how they will debit/credit your accounts.

- **Will there be a penalty threshold, and how will it be calculated?**

No threshold will be applied by the CSD in charge of the penalty calculation. Penalty calculation will be made at the end of each day after ISD, on each late matched/ failed S/D instructions.

- **Will you apply a threshold below which penalties/indemnities will not be passed on to your clients?**

If a cash penalty is imposed, a strict pass-on approach will be applied with no threshold application.

- **For penalties, what will happen with instructions already failing before the go-live (activation date) of SDR?**

The ECSDA “CSDR Penalties Framework” (April 2020)⁴ has mentioned the following main principles:

- No SEFP or LMFP applies for a business day prior to the activation date.
- In case an instruction with ISD prior to the activation date is matched in the settlement system on or after the activation date, the CSD will compute a LMFP. Nevertheless, in the computation of this LMFP, the CSD will not consider the business days prior to the activation date

⁴ https://ecsda.eu/wp-content/uploads/2020/04/2020_04_17_ECSDA_CSDR_Penalties_Framework_Draft.pdf

4. MANDATORY BUY-INS

- **What is the scope of Buy-ins?**

The Buy-in scope is mostly the same as the scope for penalties (except that repos with term < 30 days are excluded from the scope of mandatory Buy-in).

Therefore, like the penalty regime, non-European parties to instructions impacted by mandatory buy-in would be part of such process.

- **Who will be responsible for initiating the buy-in?**

For non CCP trades, SDR mandates the Receiving Trading Party (RTP) to initiate a buy-in for the outstanding undelivered stock at the expiration of the applicable extension period.

The Receiving Trading Party (RTP) must appoint a Buy-in Agent and inform the Failing Trading Party (FTP) of the initiation of buy-in.

The Failing Trading Party has to set his instruction on hold and inform its CSD participant.

It is important to notice, at the timebeing, there is only one market participant that has declared itself as a buy-in agent. Along with the industry and ICMA (International Capital Markets Association), we consider that is a main market concern. We measure it may become a significant challenge for the February go-live.

- **How will Société Générale Global Markets communicate for buy-ins?**

New message types will be put in place:

- To inform the Delivering Trading Party: pre-notification and notification (format standard not yet known)
- To put instructions on Hold Status and to inform the CSD of the result of the Buy-in operation: MT530

If the transaction is cleared by a CCP, then the CCP will be responsible for initiating the buy-in (this already exists today).

- **Will collateral instructions be excluded from scope of buy-ins?**

The current version of SDR includes collateral instructions both for penalties and mandatory buy-in.

Industry Associations have written to the European Securities and Markets Association (ESMA) asking it to clarify whether collateral instructions are in scope of SDR and arguing that they should not be.

- **How does Société Générale Global Markets see the pass-on mechanism working?**

For the time being, pass-on is not part of SDR.

However, there are on-going discussions with ESMA to introduce this mechanism.

It is our view that as soon as we receive a valid pre-notification or notification on our failing delivery and we identify that it is part of a settlement chain, we intend to pass-on a pre-notification or a notification to our counterparties which fail to deliver to us.

- **For Buy-ins, what will happen with instructions already failing before the go-live (activation date) of SDR?**

We do not currently have visibility of the go live scenario for existing failing instructions.

5. CONTRACTUAL FRAMEWORK / SLA

- **Will amendments be required to the contractual arrangements between Société Générale Global Markets and its clients?**

Yes, Société Générale Global Markets will have to put in place contractual arrangements with its clients and counterparties which facilitate mandatory buy-in as well as cash penalties and the sending of allocations and confirmations where necessary.

We are following industry discussions and lobbying of the European authorities in order to determine the best approach to amending contracts with a view to minimising the required paperwork to the extent possible. Solutions will depend on the products involved and may include bilateral amendments to agreements, multilateral amendments to agreements (such as adherence to industry protocols) and/or the updating of general terms of business.

Where possible, we will seek to rely on amendments to the rules and documentation of industry associations (such as those of ICMA), trading venues, clearing houses or CSDs.

***For any further information, your usual contact will be
at your disposal.***



GLOSSARY

CET	Central European Time
CCP	Central Counterparty
CSD	Central Securities Depository
CSDR	Central Securities Depositories Regulation - Regulation No 909/2014 of the European Parliament and of the Council of July 23th, 2014 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 (EU) No 236/201
ECSDA	European Central Securities Depository Association
ESMA	European Securities and Markets Authority
IS	Settlement Instruction
ISD	Intended Settlement date
LMFP	Late Matching Fail Penalty
PSET	Place of settlement
PSAFE	Place of Safekeeping
SDR	Settlement Discipline Regime
SEFP	Settlement Fail Penalty
SR	Settlement restriction
T2S	TARGET2-Securities