

CSDR CENTRAL SECURITIES DEPOSITORIES REGULATION

SOCIÉTÉ GÉNÉRALE GLOBAL MARKETS
ANSWERS YOUR QUESTIONS ABOUT
THE SETTLEMENT DISCIPLINE REGIME

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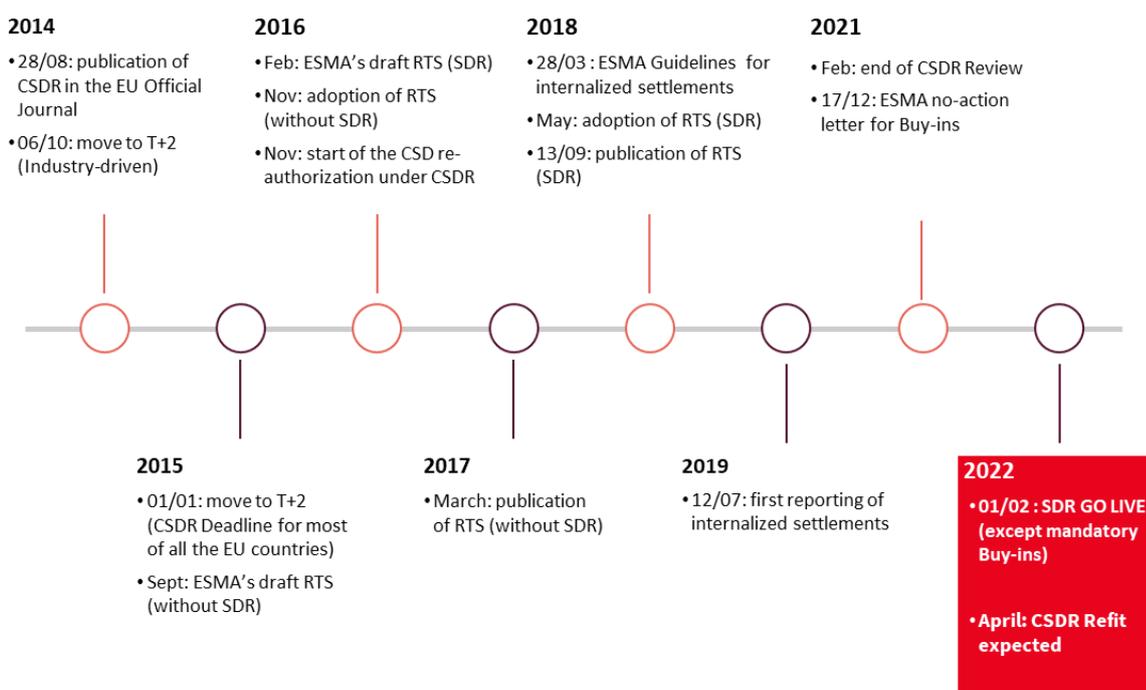
SUMMARY

The aim of this document is to inform clients of the impacts of the Settlement Discipline Regime (**SDR**) which is the next component of the Central Securities Depositories Regulation (**CSDR**). SDR will come into effect on 1 February 2022.

The contents of this document are based on the published CSDR text as at the date of each publication of this document. Société Générale will endeavour to update this document in line with amendments made to CSDR from time to time.

Following an initial postponement, the SDR and accompanying Delegated Regulation (EU) 2018/1229 **will apply from 1 February 2022**. Société Générale Global Markets has been 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 will also be of interest to a wider audience.





FREQUENTLY ASKED QUESTIONS

SETTLEMENT DISCIPLINE REGIME PRINCIPLES

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

The Settlement Discipline Regime introduces 3 sub-regimes (see below):

1. Settlement fail prevention
2. Cash penalties
3. Mandatory buy-ins (postponed)

- **Which entities will be impacted by the SDR?**

All parties in a securities settlement chain which settle on EEA CSD¹ will be impacted including non-European trading parties and participants. Although the SDR of CSDR was not onshored in the UK and will not apply to the UK, UK parties to a settlement chain which settles on an EEA CSD will be indirectly impacted by the SDR.

- **What is the status of the mandatory buy-in regime under the SDR?**

On 24 November 2021, the co-legislators of the European Parliament and the European Council confirmed their agreement to amend CSDR to allow for the application of the SDR from 1 February 2022 but without the mandatory buy-in regime. The intention of the co-legislators is to postpone the application of the mandatory buy-in regime to a future date which is yet to be confirmed.

On 17 December 2021, the European Securities Markets Authority (**ESMA**) published a forbearance statement² confirming that it would expect National Competent Authorities (**NCAs**) not to prioritise supervisory actions in relation to the application of the mandatory buy-in regime. This effectively confirms that the mandatory buy-in regime does not have to be implemented on 1 February 2022.

- **What is the status of the CSDR Review?**

In July 2021, the European Commission completed a CSDR review which concluded that it was necessary to make amendments to CSDR. As a result, changes to CSDR (including to the mandatory buy-in regime) will be proposed by the European Commission through a CSDR REFIT which is expected in April 2022.

¹ https://www.esma.europa.eu/sites/default/files/library/esma70-155-11635_cds_register_-_art_21.pdf

² https://www.esma.europa.eu/sites/default/files/library/esma70-156-5153_public_statement_on_buy-in.pdf

I. Settlement fail prevention

1. Allocation and confirmation process

To prevent settlement fails, the SDR introduces new rules which require investment firms and their clients to communicate between themselves information which is necessary for the settlement of trades.

Professional clients

Where an investment firm confirms to its professional client that an order has been executed, the investment firm must require the professional client to confirm its acceptance of the terms of the transaction and to send specific details about the allocation of securities and/or cash to the investment firm. The investment firm must confirm the receipt of this information within 2 hours.

For the purposes of this obligation 'professional client' means any entity which belongs to the list of per se professionals under Section I of Annex II of MIFID 2³, irrespective of the fact the client is, generally or for some specific transactions or services, categorised as a non-professional client (e.g. an eligible counterparty).

Retail clients

An investment firm must require its retail clients to provide it with all relevant settlement information by 12.00 CET on the following business day.

Société Générale Global Markets will communicate with clients regarding the SDR allocation and confirmation requirements.

2. Matching and population of settlement instructions

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

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

³ [Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU \(recast\).](#)

- **Transaction type field:** 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 receiving a higher cash penalty. The Place of Clearing will be used to identify if the transaction was cleared through a Central Counterparty (**CCP**).

3. CSD functionalities to assist matching and settlement

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

- **Standardised settlement matching tolerances of:**
 - 2 Euros for transactions in an amount of < 100 000 Euros (or currency equivalent)
 - 25 Euros for transactions in an amount of > 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.

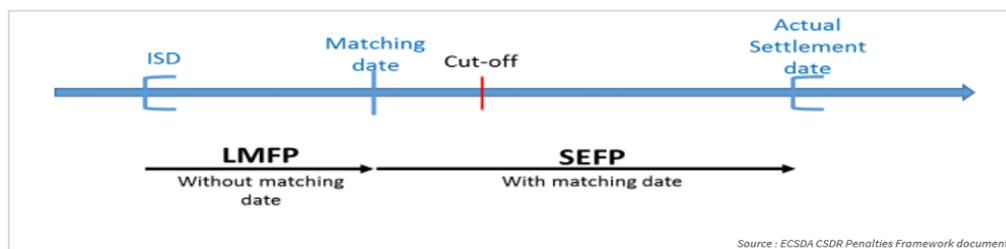
For additional information on these new CSD services, please refer to your respective custodians or specific CSDs (in case you are a direct participant).

II. 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. They 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).
- 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 is identical for all CSDs.
- The penalty incurred by the CSD participant responsible for the failure 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. This is referred to as a **Late Matching Fail Penalty (LMFP)**.
- After matching, the party responsible for the failure 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. This is referred to as the **Settlement Fail Penalty (SEFP)**.



For more detail on the implementation of the CSDR cash penalties regime, please refer to the latest updated CSDR Penalties Framework issued by the European Central Securities Depositories Association (**ECSDA**)⁴.

- **What is the instrument scope for the cash penalties regime?**

Penalties will be applied to failing instructions for the transfer of MiFID II/ MiFIR transferable securities, money market instruments, units in collective investment undertakings and emissions allowances which are intended to be settled on an EEA CSD and which are:

- admitted to trading or traded on an EU trading venue; or
- cleared (or eligible for clearing) by an EU CCP,

but excluding shares whose principal trading venue is in a third country.

⁴ https://ecsda.eu/wp-content/uploads/2021/10/2021_10_05_ECSDA_CSDR_Penalties_Framework.pdf

- **What rates will be applied?**

| | Financial Instrument type | CSDR Financial Instrument category code | Security penalty rate |
|------------------------------------|---|---|-----------------------|
| Shares | Liquid shares not traded on SME Growth Market | SHRS and liquidity indicator = « Y » | 1.00 bps |
| | Illiquid shares not traded on SME Growth Market | SHRS and liquidity indicator = « N » | 0.50 bps |
| | Liquid and illiquid shares traded on SME Growth Market | SHRS and SME Growth market flag = « Y » | 0,25 bps |
| Bonds | Corporate Bonds not traded on SME Growth Market | DEBT or MMKT | 0.20 bps |
| | Corporate Bonds traded on SME Growth Market | DEBT or MMKT and SME Growth market flag = « Y » | 0.15 bps |
| | Bonds issued by public authority traded or not traded on SME Growth Market | SOVR | 0.10 bps |
| Other Financial Instruments | Other financial instruments not traded on SME Growth Market | For all others Financial Instrument types not in (SHRS, SOVR, DEBT or MMKT) | 0.50 bps |
| | Other financial instruments traded on SME Growth Market | For all others Financial Instrument types not in (SHRS, SOVR, DEBT or MMKT) And SME Growth Markets is « Y » | 0.25 bps |

- **In what currency will the debit/ credit occur?**

As set out in the ESCDA CSDR Penalties Framework, the amount imposed by the penalty should be calculated:

- For against payment settlement fails, in the currency of the cash leg.
- For free of payment settlement fails:
 - either in the currency of the underlying security if the instrument is quoted in nominal or percent (usually fixed income instruments); or
 - in the currency of the daily reference price, if the underlying security is quoted in units (usually shares); or
 - in a default currency, as defined by and eligible for settlement in the Calculating-CSD or settlement platform.

Note that the international CSDs (**ICSDs**) Euroclear Bank SA/NV and Clearstream Banking Luxembourg S.A., acting in their capacity as the penalties Calculating-CSDs for their internal and Bridge settlement fails may calculate penalties in different currencies.

- **If a buying counterparty places a trade on hold/release after ISD+0 will it still be subject to cash penalties?**

Yes, if it is matched. It is important to note that the party placing the instruction on hold would be deemed to be the cause of the trade fail. If both parties place the trade on hold, then a separate SEFP

penalty will be raised in each direction (i.e. the delivering party will be charged with 'lack of securities' penalties and the receiving party with 'lack of cash' penalties).

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

No threshold will be applied at the CSD level (CSD in charge of penalty computation). Penalty computations will be performed at the end of each day after the ISD.

- **How will CSDR penalties be managed bilaterally?**

Where a CSD participant is charged penalties by the CSD it may, in certain circumstances, be justified for the participant to recover such penalty costs from a third party who caused the settlement failure.

In this regard, as of 1 February 2022, Société Générale Global Markets expects to follow the CSDR Settlement Discipline Penalties Market Practice for Bilateral Claims published by AFME from time to time and at its discretion. This can be found on AFME's website using this link:

<https://www.afme.eu/Portals/0/CSDR%20Settlement%20Discipline%20-%20Bilateral%20Penalty%20Claims%20August%202021.pdf?ver=2021-09-02-091345-440>

Société Générale Global Markets will communicate with clients about bilateral penalties management.

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

The ECSDA CSDR Penalties Framework mentions 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.

- **As mandatory buy-ins are deferred until a later date, are cash penalties expected to accrue indefinitely?**

Yes, penalties will accrue up until the trade is settled or cancelled. It is up to the counterparties to a trade to ensure that they settle on a timely basis. Firms may agree with their counterparty to cancel a trade outright.

Certain CSDs/ Settlement Systems (e.g. Target 2 Securities (**T2S**)) will cancel all matched instructions pending for more than 60 days from ISD.

III. Mandatory Buy-Ins (postponed)

As mentioned above, the mandatory buy-in regime of the SDR will **not** come into effect on 1 February 2022 and will be postponed to a future, yet unconfirmed, date. The mandatory buy-in regime is also likely to be amended through CSDR REFIT which is expected to be published in April 2022.

For information on CSDR regulation, please contact: sgcib-regulatory-support.par@sgcib.com



GLOSSARY

| | |
|----------------|---|
| ACPR | Autorité de Contrôle Prudentiel et de Résolution (the French Prudential Control and Resolution Authority) |
| AFME | Association for Financial Markets in Europe |
| AMF | Autorité des Marchés Financiers (the French financial markets regulator) |
| 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 |
| ECB | European Central Bank |
| ECSDA | European Central Securities Depository Association |
| EEA | European Economic Area |
| ESMA | European Securities and Markets Authority |
| FCA | Financial Conduct Authority |
| ICSD | International CSD |
| ISD | Intended Settlement Date (eq. to Value Date) |
| LMFP | Late Matching Fail Penalty |
| MIFID 2 | Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) |
| NCA | National Competent Authority |
| PRA | Prudential Regulation Authority |
| SDR | Settlement Discipline Regime |
| SEFP | Settlement Fail Penalty |
| SETR | Type of Settlement Transaction Indicator |
| SFSA | Swedish Financial Supervisory Authority |
| SME | Small Medium Enterprise |
| T2S | TARGET2-Securities |