

Clearstream

The Central Securities Depositories Regulation (CSDR)

A briefing paper on customer impacts



Key impacts

New settlement discipline regime

- CSD customers will be subject to mandatory buy-ins and cash penalties when settlement fails

Wider CSD customer impacts include

- New account segregation rules
- Daily reconciliation processes
- Book-entry form of securities
- Use of Legal Entity Identifier codes

New operating licence for CSDs

- Performance and operational criteria
- Enhanced governance, price transparency and more stringent prudential requirements

The Central Securities Depositories Regulation (CSDR) is one of the key regulations adopted in the aftermath of the financial crisis. Its objectives are:

- To increase the safety and efficiency of securities settlement and the settlement infrastructures in the EU;
- To harmonise the different rules applicable to Central Securities Depositories (CSDs) in Europe; and
- To establish an enhanced level playing field amongst these CSDs.

The regulation applies to all CSDs in the EU, along with those of Iceland, Liechtenstein and Norway (as and when incorporated into the European

Economic Treaty). Switzerland is also to be subject to certain CSDR provisions via bilateral agreement.

The CSDR is significant to all financial market participants in Europe – and globally – as it introduces measures that not only impact European CSDs, but also the wider financial market infrastructures and global trading parties dealing in securities that settle in an EU CSD or at either of the international CSDs (ICSDs).

Trading parties, central counterparties (CCPs) and trading venues will also be impacted and will have to directly comply with some of the measures, in particular with the introduction of mandatory buy-ins and penalties for settlement failures.

The following information is based on Clearstream's own interpretations, and is provided to support Clearstream customers with their understanding of a specific EU regulation. This information does not constitute – nor is it intended to act as – any form of formal legal advice.





“We receive queries from customers of all sizes and profiles about the CSDR. We’d like to offer more insight into what we think this regulation will mean for the market infrastructure our customers depend on to execute their financial transactions – like Clearstream’s Central Securities Depositories – and for the financial institutions themselves.

Most of our customers’ interest is in the settlement discipline regime, which will bring in mandatory buy-ins and cash penalties when settlement fails, so this is the main focus of this briefing.

Our door is open to further dialogue with customers – indeed we have been feeding into various industry working groups to help form practical solutions with our customers’ interests at heart.”

Philip Brown
Co-CEO, Clearstream Banking

A piece of the EU regulatory jigsaw

The CSDR is one piece of a wider EU regulatory jigsaw, reflecting a review of the entire securities and capital markets structure with a view to improving the functioning and stability of the financial markets. It can be seen as contributing to the EU’s Capital Markets Union agenda to sustain the EU’s global competitiveness based on stable and liquid capital markets.

As such, this regulation is complementary to other EU financial markets regulations, such as the Market in Financial Instruments Directive (MiFID), the Directive on Alternative Investment Fund Managers (AIFMD), the Undertakings for the Collective Investment of Transferable Securities (UCITS) Directive, the European Market Infrastructure

Regulation (EMIR) for the regulation of over-the-counter (OTC) derivatives and the Capital Requirements Directive IV (CRD IV) for prudential rules for banks.

We expect that the CSDR will contribute to CSDs’ compliance with the international principles for financial infrastructures set out by the Committee on Payments and Market Infrastructures (CPMI) and the Technical Committee of the International Organisation of Securities Commissions (IOSCO). The standards designed by these organisations help to ensure that the infrastructure supporting global financial markets is robust and well placed to withstand financial shocks.

Enhanced operational efficiency and asset protection

Clearstream embraces the changes CSDR brings. We are committed to ensuring that customers continue to benefit from the services we offer today, in an even safer and more efficient environment.

A new settlement discipline regime is a key feature of the CSDR and aims to increase the operational efficiency of CSDs. The regime introduces a host of measures designed to incentivise timely settlement by introducing a **mandatory cash penalty and buy-in mechanism**.

CSDR also requires all CSDs to apply for a universal **CSD licence to operate**. The licence sets out performance and operational criteria all CSDs must fulfil including, but not limited to, enhanced governance, price transparency and more stringent prudential requirements. To help increase asset protection, CSD customer on-boarding and risk management protocols are also addressed in the CSDR.

The settlement discipline regime: Introducing new efficiency measures

Measures to prevent settlement fails

Investment firms and trading parties will have to share – on a tighter timeframe and in more granular detail than today – **information concerning confirmations of executed transaction orders**.

CSDs are required to harmonise **mandatory matching fields** and countervalue matching **tolerance levels for against payment instruction settlements**, in order to introduce **a bilateral cancellation facility, a hold and release mechanism and partial settlement**. These measures are designed to bring existing functionalities in line with settlement in TARGET2-Securities (T2S, European centralised settlement via the European Central Bank settlement platform). The CSDR objective to achieve a harmonised “T+2”

settlement cycle (two days following the transaction date) for all European markets has in the meantime been fulfilled when Spain migrated to this settlement cycle in September 2016.

Measures to monitor 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.

Measures to address 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 the table below, as set out in the EU Commission delegated Regulation C(2016) 7154 final that entered into force on 30 March 2017.

Clearstream is contributing to the relevant securities markets associations, like the European Central Securities Depositories Association (ECSDA), the Association for Financial Markets in Europe (AFME) and the International Capital Market Association (ICMA) to help develop practical industry solutions for these measures.

Cash penalty rates

Type of fail	Rate
1. Settlement fail due to a lack of shares that have a liquid market, excluding shares referred to in point 3.	1.0 basis point
2. Settlement fail due to a lack of shares that do not have a liquid market, excluding shares referred to in point 3.	0.5 basis point
3. Settlement fail due to a lack of financial instruments traded on SME growth markets, excluding debt instruments referred to in point 6.	0.25 basis point
4. Settlement fail due to a lack of debt instruments issued or guaranteed by: (a) A sovereign issuer; (b) A third country sovereign issuer; (c) A local government authority; (d) A central bank; (e) Any multilateral development bank referred to in Articles 117(1) and 117(2) of the CSDR Level 1 text; (f) The European Financial Stability Facility or the European Stability Mechanism.	0.10 basis point
5. Settlement fail due to a lack of debt instruments other than those referred to in points 4 and 6.	0.20 basis point
6. Settlement fail due to a lack of debt instruments traded on SME growth markets.	0.15 basis point
7. Settlement fail due to a lack of all other financial instruments not covered in points 1 to 6.	0.5 basis point
8. Settlement fail due to a lack of cash.	Official interest rate for overnight credit charged by the central bank issuing the settlement currency with a floor of 0.

Example scenario of the cash penalty rates in practice

(I)CSD = Clearstream Banking S.A
Securities = Internal delivery of
1,000 liquid shares against
payment of EUR 100,000.

Settlement status: A settlement instruction is matched, but fails due to lack of securities for three business days after the intended settlement date.

The applicable daily penalty rate would in this example be 1.0 basis point. Let us suppose that the reference price (in this example being the closing price of the shares on the most relevant market in terms of liquidity) to be applied for penalty calculation is as follows:

Day 1: EUR 100
Day 2: EUR 115
Day 3: EUR 90

The penalty would therefore be calculated as follows:

Penalty day 1: 1,000 shares x 0.01% x
100 EUR = 10 EUR

Penalty day 2: 1,000 shares x 0.01% x
115 EUR = 11.50 EUR

Penalty day 3: 1,000 shares x 0.01% x
90 EUR = 9 EUR

Total penalty amount = 30.50 EUR.

The total penalty amount would have to be paid by the customer that is failing to deliver the securities, to the customer suffering from the failure to receive securities. Such payments will be facilitated by the (I)CSD – in this example, Clearstream Banking S.A.

– A **mandatory buy-in process** will be introduced for all financial instruments not delivered within a set period following the intended settlement date. All parties in the settlement chain are to contractually agree on the mandatory buy-in process.

– **Settlement suspension**: CSDs will identify, sanction and ultimately suspend customers that consistently and systematically fail to deliver securities. This constitutes a new responsibility of the CSD as no systematic monitoring or sanctioning exists today.

Spotlight on mandatory buy-in process

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 (for liquid securities, up to four business days after the intended settlement date; for illiquid securities, up to seven business days and for SME growth market securities, up to 15 business days).

Clearstream will provide further scope clarification on the following once confirmed by the EU Commission and ESMA.

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

- All matched settlement instructions in financial instruments (transferable securities, money-market instruments, units in collective investment undertakings, emission allowances or other instruments) as long as they are admitted to trading on a trading venue;
- CCP-cleared transactions.

Transactions exempt from the buy-in process are:

- Settlement instructions in financial instruments not admitted to trading;
- Transactions in shares for which the principal venue for the trading of shares is located in a third country (in line with the EU Short Selling Regulation);
- Operations of several transactions (including securities repurchase

- or lending agreements) with a term leg within 30 days; and
- All transactions where relevant financial instruments no longer exist or during the settlement suspension period in case of reconciliation problems.

As a new legal requirement related to buy-ins, a mandatory application of partial settlement will be introduced for clearing members, trading venue members or trading parties where, 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 is offered by the CSD.

Clearstream CSDs will implement partial settlement for its CSDs.

Asset protection measures

Reconciliation, customer on-boarding and risk management protocols are also within the CSDR scope.

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 ring-fence the break and to contain the risk.

Clearstream is already performing reconciliation measures to seek to ensure the integrity of any given

issue in question and to resolve reconciliation breaks as soon as possible. Clearstream is working closely with relevant industry partners in the custody chain, such as depositories, transfer agents and registrars to ensure compliance with the CSDR reconciliation requirements.

Customer on-boarding frameworks and risk management protocols:

CSDR requires CSDs to provide fair and open access to their services while being sure that their customers do not expose one another to undue risk.

Clearstream already has a strict Know Your Customer (KYC) policy in place to check the integrity of its customers and their underlying customers as far as possible. Clearstream is continually reviewing its KYC and risk management protocols, including in the context of CSDR requirements.

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, which is chaired by Mathias Papenfuß, the European Central Securities Depositories

Association (ECSDA) Chairman and Clearstream's Chief Operating Officer. This Task Force, which has been founded at the T2S CSD Steering Group level, is analysing the CSDR requirements either impacting T2S functionalities or requiring new T2S functionalities.

One issue to be determined is the extent to which the CSDR settlement penalties calculation and processing for T2S settlement instructions can be directly embedded into the T2S platform rather than each CSD having to build up individual systems for this purpose.

Banking-type ancillary services

The CSDR sets out a new prudential framework to govern CSD banking-type ancillary services, such as certain cash credit and payment services, as defined in Section C of the Annex to the CSDR Level 1 text.

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. This is not mandatory for CSDs which do not provide banking-type ancillary services, such as LuxCSD.

We are addressing the requirements in such a way so as to ensure that our current services will continue with minimal customer impact. Clearstream will share more details about these measures in its future communications to customers.

CSD customer obligations



In addition to being subject to the settlement discipline regime, CSD customers are directly impacted by the CSDR by the following provisions.

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. Both omnibus and segregated accounts are already offered by Clearstream as part of the flexibility we offer customers.

Additionally, as one of the new requirements, CSD customers will need to offer their own clients the choice between omnibus client segregation and individual client segregation.

Both CSDs and their customers will be required to disclose the levels of protection and the costs associated with the different levels of segregation, ensuring that investors are aware of the risks and costs associated with each segregation option to allow them to make an informed choice. Clearstream is contributing to industry efforts to find ways to further harmonise such disclosure requirements within Europe.

Internalised settlement: 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. At Clearstream, book-entry representation at CSD level can be achieved either via dematerialisation (with no paper or registry at all) or immobilisation of securities (where the paper securities are held in the vault, but not circulated).

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 to help harmonise data collection and reporting across the value chain. This is a new requirement as CSDs do not currently need to collect LEIs. By collecting LEI data, CSD reporting practices are brought in line with those set out under the European Market Infrastructure Regulation (EMIR) for derivative contracts. LuxCSD's LEI service team can help CSD customers both in obtaining LEIs for the first time and maintaining LEIs previously issued through LuxCSD (see: www.luxcsd.com.)

Clearstream's applications for CSDR licences

Clearstream CSDs have submitted their applications for the relevant CSDR operating licences.

The CSDR licence application process involved each of the Clearstream CSDs applying to the relevant National Competent Authorities in Germany

or in Luxembourg for authorisation, and was conducted in parallel for the following:

- [Clearstream Banking AG](#) (Clearstream Banking Frankfurt, CBF);
- [Clearstream Banking S.A.](#) (Clearstream Banking Luxembourg, CBL); and
- [LuxCSD S.A.](#) (LuxCSD).

In addition, Clearstream Banking Luxembourg submitted an application for authorisation of [the Bridge](#), which is considered an "interoperable link" existing between Clearstream Banking Luxembourg and Euroclear Bank, to its National Competent Authorities.

Implementation roll-out

EU Member State CSDs had six months, starting from 31 March 2017 (following the publication of CSDR Level 2 legal acts in the Official Journal on 10 March 2017), to submit their CSDR application files with their respective National Competent Authorities.

A more detailed timeline with indicative dates is available on the Clearstream's [dedicated CSDR webpages](#).

Further information

Customers are invited to consult Clearstream's [CSDR webpages](#) or contact their Relationship Manager for more specific information.

LuxCSD customers may also consult the [LuxCSD dedicated regulatory webpages](#) or contact their Relationship Manager.

Clearstream references

Unless otherwise stated, "Clearstream" in this briefing refers to all three Clearstream Central Securities Depositories (CSDs):

- Clearstream Banking AG (referred to as Clearstream Banking Frankfurt or CBF), as German CSD;
- Clearstream Banking S.A. (referred to as Clearstream Banking Luxembourg or CBL), as International Central Securities Depository; and
- LuxCSD S.A. (referred to as LuxCSD), as Luxembourg CSD. LuxCSD is a joint venture established in Luxembourg between the Central Bank of Luxembourg (BcL) and CBL.

CSDR text references

The CSDR is set out in a number of EU texts. CSDR Level 1 text is the main body of the regulation, with the official reference, Regulation (EU) No 909/2014, as published in the Official Journal on 28 August 2014.

The Level 1 text is complemented by a series of Level 2 texts which detail the regulatory technical standards and implementing technical standards. These are drawn up by the relevant authorities, such as the European Securities and Markets Authority (ESMA) for CSD requirements and the settlement discipline regime and the European Banking Authority (EBA) for prudential requirements. For a status overview of the Level 2 texts, please refer to [ESMA CSDR webpages](#) and the [EBA webpages for CSD prudential requirements](#).

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