Central Securities Depositories Regulation (CSDR) & Settlement Discipline Regime (SDR) Fact Sheet

BNP Paribas
Central Securities Depositories Regulation (CSDR) & Settlement Discipline Regime (SDR)
2022
All European Economic Area (EEA) and non-EEA entities settling transactions concerning in scope financial instruments through EEA Central Securities Depositories will be affected by the settlement discipline regime under the Central Securities Depositories Regulation. The following factsheet gives an overview of the CSDR Settlement Discipline Regime.

1. BACKGROUND

The Central Securities Depositories Regulation (“CSDR”) is one of the key regulations adopted in response to the 2008 financial crisis setting up a European-wide regulatory framework for the institutions responsible for securities settlement, called Central Securities Depositories1 (“CSDs”) e.g. Euroclear, Clearstream. CSDR refers to the European Regulation (EU) No 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on EEA CSDs.

While much of the regulation focuses on the prudential, organisational and business standards of CSDs, it also introduces new settlement discipline measures (Articles 6 and 7 of the Regulation, the “Settlement Discipline Regime”) which directly affect EEA investment firms2 offering execution services and EEA/non-EEA trading entities and custodians that settle trades on EEA CSDs.

This document sets out a summary of the Settlement Discipline Regime (“SDR”) which is will apply from 1 February 2022 covering three main pillars:

- **Prevention measures/”Allocation & Confirmation”:** EEA investment firms are required to take measures to limit the number of settlement fails, namely by promoting discipline across the settlement processes and by offering electronic channels to communicate settlement instructions and allocations.
- **Penalty Mechanism: new penalties will be charged by EEA CSDs for transactions on those CSDs which fail to settle on the intended settlement date.**
- **Buy-in measures ("Buy-In"):** the buy-in regime is being revised within CSDR REFIT (see below) with a date of application yet to be defined by the EU legislators.

Note that, following a CSDR Review consultation with the industry stakeholders, a legislative proposal from the European Commission (“EC”) is expected later in Q2 2022 (“CSDR REFIT”). This proposal may result in changes to the SDR and other requirements detailed in this factsheet.

BNP Paribas has actively contributed to the industry responses to the consultation (in particular, the Association for Financial Markets in Europe (“AFME”), the International Capital Markets Association (“ICMA”) and the International Swaps and Derivatives Association (“ISDA”) strongly advocated for modifications to the SDR and continue to monitor the developments of the CSDR REFIT.

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1 A central securities depositary (“CSD”) is a legal person that operates a securities settlement system and at least one core services set out in the Annex of CSDR and on an ESMA list of “designated securities settlement systems”:

2 “Investment firm” means any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis (See Art 4(1) of the MiFID Directive 2014/65/EU).
2. SCOPE

Entities in scope
The Allocation and Confirmation requirements under CSDR SDR (see below) must be complied with by EEA investment firms (such as BNP Paribas) when executing transactions in In-Scope Instruments (see below) for a client.

The Penalty Mechanism under CSDR SDR (see below) applies to EEA CSDs and their participants in relation to In-Scope Instruments (see below).

Instruments in scope of the settlement discipline measures (“In-Scope Instruments”)
Transactions in relevant financial instruments that are settled on an EEA CSD.
The relevant financial instrument types are:

- Transferrable securities, being the following:
  - Shares in companies (whether listed or unlisted, admitted to trading or otherwise), comparable interests in partnerships and other entities and equivalent securities;
  - Bonds and other forms of securitised debt (including sovereign debt);
  - Depositary receipts in respect of the instruments above;
  - Securities giving the right to acquire or sell transferable securities (for example, warrants, options, futures and convertible bonds);
  - Securitised cash-settled derivatives, including certain futures, options, swaps and other contracts for differences relating to transferable securities, currencies, interest rates or yields, commodities or other indices or measures;
- Money-market instruments;
- Units in collective investment undertakings;
- Emission allowances.

Note the CSDR REFIT which is expected to be published in Q2 2022 may lead to changes to the scope of instruments and transactions subject to the SDR.

3. IMPACT OF BREXIT

As the SDR requirements were due to come into force after the Brexit transition period which expired on 31 December 2020 the UK was not required to implement (or ‘onshore’) them. On 23 June 2020, a UK Ministerial Statement clarified that the Government would not be implementing the EU settlement discipline regime into UK law. This means that:

- UK CSD-settled instruments will not be subject to daily settlement penalties from February 2022;
- Existing industry and contractual procedures for settlement fails (such as under the ICMA Rules) do not technically have to change in relation UK CSD-settled instruments.

Note however that:
- The UK government has mentioned that it may implement a UK-specific alternative framework for settlement fails in the future and will consult the industry.
- Any trading venues, CCPs and firms who trade or clear EEACSD-settled instruments will still need to comply with the EU SDR requirements.
- Contractual arrangements may need to reflect settlement discipline requirements in contractual arrangements in respect of EEA CSD-settled instruments (including for UK and non-EEA clients and counterparties) to comply with EU SDF.
4. SETTLEMENT DISCIPLINE REGIME (“SDR”)

Measures to Prevent Settlement Fails – Allocation and Confirmation (“A&C”)

CSDR Article 6 introduces preventive measures that BNP Paribas and other MiFID II investment firms are required to implement to limit settlement fails.

- To avoid settlement failures, BNP Paribas is required to collect transactional information to facilitate the settlement of transactions. This includes requiring clients to send allocations, certain settlement information and agreeing in writing confirmations for each executed trade within a set timeframe.
- BNP Paribas will provide written allocations and confirmations to our clients where required either through manual or automated communication channel (Note: BNP Paribas encourages its clients to use electronic platforms such as CTM, TRAX, Transcom, SWIFT etc.).
- BNP Paribas will offer clients the option of sending allocations / confirmations electronically, via an appropriate platform.

Measures to Address Settlement Fails

Penalty Mechanism

- CSDR Article 7 establishes a penalty mechanism as a measure to address settlement failures. If CSD participants fail to settle transactions on the intended settlement date (“ISD”), the relevant EEA CSD will apply penalties to the failing participants (which will be collected by the CSD and paid to the receiving participant) until settlement. CSDs will charge their participants daily from the day after the ISD and penalties will be collected by the CSDs on a monthly basis and on a net basis. CSD participants may elect to recharge /redistribute penalties to the clients responsible for the fail.
- Each CSD participant including BNP Paribas needs to implement relevant processes to receive daily and net monthly penalties information from the CSD and to have processes in place to pay penalties to the relevant EEA CSD as needed.
- Penalty rates will be applied to the market value of the transaction and range from 0.1 bps for government bonds to 1 bps for liquid shares as per the table below:

<table>
<thead>
<tr>
<th>Fail Type</th>
<th>Security Type</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of securities</td>
<td>1. Liquid shares (excluding those referred to in 3)</td>
<td>1.0 bps</td>
</tr>
<tr>
<td></td>
<td>2. Non-liquid shares (excluding those referred to in 3) or other types of financial instruments not captured 1 or 3 to 6)</td>
<td>0.5 bps</td>
</tr>
<tr>
<td></td>
<td>3. Financial instruments traded on SME Growth Markets (excluding those referred to in 5)</td>
<td>0.25 bps</td>
</tr>
<tr>
<td></td>
<td>4. Corporate bonds</td>
<td>0.20 bps</td>
</tr>
<tr>
<td></td>
<td>5. Bonds traded on SME Growth Markets</td>
<td>0.15 bps</td>
</tr>
<tr>
<td></td>
<td>6. Government and Municipal bonds</td>
<td>0.10 bps</td>
</tr>
<tr>
<td>Lack of cash</td>
<td></td>
<td>CCY discount rate (floor=0)</td>
</tr>
</tbody>
</table>

Formula: Business Day(s) * price* penalty rate

Buy-In - delayed (New CSDR Settlement Discipline legislative timeline)

CSDR mandates that buyers may initiate a mandatory buy-in process when the seller delays settlement beyond an extended period after the intended settlement date.

Subsequent to extensive advocacy from industry participants explaining the foreseeable negative impact of these rules the implementation of this “Mandatory Buy-in regime” will be postponed. This will allow time to redesign the regime or perhaps form consensus that it could be abandoned.

The EU co-legislators politically agreed on 24 November 2021 to postpone the Mandatory Buy-in regime. This delay will be enacted around March 2022 which means after the scheduled start of the Mandatory Buy-in regime on 1 February 2022. This creates a “grey period” where the regime is technically in force but pending deferral. Unable to issue formal forbearance, ESMA published a “relief“
statement on 17 December 2021 suggesting national regulators should “not to prioritise supervisory actions” relating to “Mandatory Buy-Ins”.

Multiple trade associations responded with a public statement to clarify that their members will not “take further action towards implementation of the mandatory buy-in requirements”.

AMF (BNP Paribas’ regulator) announced on 23 December 2021 that it “does not expect the industry to implement the buy-in regime on 1 February 2022”.

5. DOCUMENTATION - REPAPERING

In January 2022 BNP Paribas, in a process widely known as repapering, sent all in-scope counterparties new documentation detailing conformance with the Allocation and Confirmation requirements of CSDR. The requirement for this documentation is an explicit provision of CSDR and is based on industry-standard wording.

The previously proposed Mandatory Buy-in regime had also included requirements for repapering. Given that ESMA recommended the deprioritisation of supervisory actions related to the Mandatory Buy-in regime, and AMF does not expect the industry to implement the Mandatory Buy-in regime, BNP Paribas is not going to conduct this repapering exercise at this time.

6. FOR FURTHER INFORMATION

Please check the below podcast produced by our colleagues at BNP Paribas Securities Services on CSDR:

Central Securities Depositories Regulation (CSDR) - regulation memo - Securities Services (cib.bnpparibas)

Central Securities Depositories Regulation (CSDR) & Settlement Discipline Regime (SDR) – are you ready? - Securities Services (cib.bnpparibas)

CSDR and settlement discipline regime - Are you ready? - For Institutional Investors - Securities Services (cib.bnpparibas)

For Financial Intermediaries - CSDR & settlement discipline regime - Securities Services (cib.bnpparibas)

CSDR and the settlement discipline regime - Securities Services (cib.bnpparibas)

If you have any further questions, please contact us at csdr.enquiries@uk.bnpparibas.com or via your usual relationship or sales contact.

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