Contents

Foreword 02
Background 03
Timeline 04
Aims and Scope 05-06
Themes 07
Settlement Discipline Regime 08-11
Summary 12
Biographies 13
References 14
Following the 2008 financial crisis, and the subsequent introduction of a T+2 settlement cycle across European markets ahead of Target2-Securities, The European Commission (EC) decided that EEA (European Economic Area) Central Securities Depositories (CSD) needed to harmonise their trading practices, and improve safety and efficiency of transaction settlement.

Central Securities Depositories Regulation (CSDR) aims to introduce rules to harmonise the authorisation and supervision of CSDs across the EEA by establishing uniform requirements for the settlement of financial instruments in the Union supported by a new Settlement Discipline Regime (SDR) to promote safe and efficient settlement.

Where do you sit in the CSDR chain?
Since the 2008 financial crisis the EU have been implementing controls and regulations to ensure safe and efficient running of the financial systems while ensuring investor protection. CSDR is the final piece of this program focusing on measures to protect CSDs, their clients and investors. The regulation aims to increase the safety and efficiency of securities settlement and settlement infrastructures in the EU and EEA.

Trading venue regulation  
Transparency  
Best execution  
Dual sided transaction reporting  

Securities financing trade regulation  
Repos  
Lending transactions  
Reporting

CSDR  
Regulation of CSDs and CSD flow

EMIR  
Regulation of CCPs and cleared flow

MiFID II  
Pre & Post trade transparency at Trading Venues

SFTR  
Regulation of shadow banking

Regulation of CCPs  
Clearing  
Initial Margin  
Single side transaction reporting  

CSD regulation and authorisation  
Settlement discipline regime  
Buy-in and penalties
CSDR Timeline
We are only half way

Oct 2014
T+2 Shorter settlement cycles implemented for most classes of securities

2014
CSDR Level I published in EU Official Journal

2017
CSDR Level 2 texts published

2018
CSDs submit authorisation applications. Most now authorised, remainder likely to be done 1H 2020. CSD participants upon authorisation offer clients choice of omnibus or segregated accounts

2019
Internalised Settlement quarterly reporting data collection begins, first report due July 2019 - delayed in some countries to September 2019

Feb 2021
New Settlement Discipline rules apply, including mandatory buy-ins.1

2021

2025
Mandatory dematerialisation or immobilisation of securities

Note:
1. The European Securities and Markets Authority (ESMA) has published a final report recommending the postponed application until 1 February 2021 of the CSDR regulatory technical standard (“RTS”) on settlement discipline.

14
CSD Regulation

Aims of CSDR

The Central Securities Depositories Regulation aims to harmonise the authorisation and supervision of CSDs across the EEA. It establishes uniform requirements for the settlement of financial instruments in the Union and rules on the organisation and conduct of CSDs to promote safe, efficient and smooth settlement. It imposes a number of standardised obligations on market participants regarding certain aspects of the settlement cycle and discipline and provides a common set of requirements for CSDs operating securities settlement systems.

These obligations aim to:
- Improve the safety and efficiency of securities settlement in Europe
- One set of rules, standards and prudential requirement to increase resilience for European CSDs
- Harmonisation of national regulation currently supervising European CSDs
- Harmonising the approach to cross border European settlement

The Central Securities Depositories Regulation will do this through a number of uniform measures:
- Shorter settlement cycles
- Settlement discipline measures including penalties and mandatory buy-ins for settlement fails
- The obligation for CSDs and their participants to offer clients the options of segregated or omnibus accounts
- Dematerialisation for all transferable securities
- Strict prudential and conduct of business rules for CSDs
- Strict access rights to CSD services
- Increased prudential and supervisory requirements for CSDs and other institutions providing banking services ancillary to securities settlement

Scope

Despite its name the Central Securities Depositories Regulation imposes mandatory obligations on a wider group of institutions than just the EU Central Securities Depositories. The obligations are also not limited to the activities of the CSDs but create responsibilities throughout the securities settlement chain.

The regulation applies to all participants in a securities settlement system as defined in Article 2 of Settlement Finality Directive (SFD). This includes institutions, central counterparties, settlement agent or clearing houses. The SFD further defines “institutions” to include credit institutions, investment firms and publicly guaranteed undertakings.

The effect of this definition is that the CSD and all parties between the CSD and the underlying fund are included in CSDR.

The scope of CSDR relates to all securities as defined in MiFID II which settle in a European Settlement System. This includes transferable securities, shares, money market instruments, units in collective investment scheme and emission allowances. They must however settle in an authorised European settlement system as listed by ESMA.

CSDR applies to buys/sells, repurchase transactions, collateral management operations, securities lending and borrowing operations and any other transaction for which the CSD provides identification via more granular ISO codes.

Exceptions exist to all of these features including securities issuance, creation and redemption of units and shares whose primary market is outside of Europe. The exceptions apply to all or certain aspects of CSDR.
Markets in scope

EEA Countries
Austria
Belgium
Bulgaria
Croatia
Republic of Cyprus
Czech Republic
Denmark
Estonia
Finland
France
Germany
Greece
Hungary
Iceland
Ireland
Italy
Latvia
Lichtenstein
Lithuania
Luxembourg
Malta
Netherlands
Norway
Poland
Portugal
Romania
Slovakia
Slovenia
Spain
Sweden

Scope includes all EEA CSDs, their participants, and trades settling in the EEA.

This comprises all EU member states, plus Liechtenstein, Iceland and Norway

There will also be extraterritorial impact.

United Kingdom out of scope:
A Written Ministerial Statement, dated 23rd June 2020, from the UK Government advised ‘the UK will not be implementing the EU’s new settlement discipline regime’.
CSDR explained

The three themes of CSDR

CSD requirements and authorisation

CSDs will be required to obtain new licenses to enable them to continue to provide services. CSD measures provide for daily reconciliation and segregated accounts and disclosure of risk and cost.

- CSD T&Cs may be amended to reflect CSDR requirements
- Securities accounts must be reconciled daily
- Participants must reconcile with CSD daily
- CSDs and participants must offer clients a choice between segregated and omnibus accounts
- CSDs must disclose risks, costs and levels of protection associated with each account

Internalised settlement

Internalised settlement is settlement that occurs between accounts at the CSD participants but does not result in a movement of securities at the CSD. CSDR requires reporting of all internalized settlement to the participants National Competent Authority (NCA).

- Reporting is to be made quarterly
- First reporting period was Q2 2019, due on 12 July
- Reporting is by aggregate volume split by instrument type, transaction type, client type, issuer CSD and failed transactions
- Entities are required to provide a report per LEI

Settlement Discipline Regime

The settlement discipline regime (SDR) introduces measures with the most significant impact on the CSD participant. SDR comprises of a number of measures designed to Prevent, Monitor, Address and Report settlement failures.

- Measures to prevent settlement fails include rules concerning allocation and confirmation.
- Further preventative measures mandate how a CSD must process settlements
- Measures to address settlement failures include the introduction of mandatory buy-in and penalties
- Monitoring and reporting measures are designed to notify participants of settlement failures and also report participants who have persistent failure of trades

As all parties in the settlement chain must ensure that the CSDR measures are adhered to we expect CSDs and the participants to update their contractual terms. This will include changes to custody agreements. It is not clear at this stage whether the buy-side will be asked to update their IMAs with their clients.

Clients requesting segregated accounts will require buy-side firms to update SSIs and notify counterparts.

This part of the regulation impacts any buy-side investment firm operating securities accounts on behalf of their clients while holding the securities in an omnibus account at a CSD or other CSD participant. This structure is particular prevalent amongst wealth managers.

Buy-side firms will need to adopt new processes to cater for the mandatory buy-ins and settlement penalties. This will be discussed in more detail later in this document.
Prevent: Measures to prevent settlement fails

Buy-side impacts of CSDR

CSDR introduces measures to prevent settlement fails. These measures impact both the activities between buy-side and sell-side firms when confirming trades, and also the participant further down the chain when settling the trades.

The impacts to the buy-side are as follows:

Written allocation and confirmation: Sell-side firms require the buy-side to send allocations by cob or at the latest midday the following day. It is expected that they will amend their T&Cs to ensure the buy-side firm adheres to this.

Transaction Code: Firms are required to include in the confirmation process the transaction code. This is subsequently required to be sent through the settlement chain to the CSD.

SSI: Unless exchanged in advance SSIs must be exchanged on all transactions. Subsequent ESMA Q&A responses have allowed the use of ALERT if contractually agreed between firms.

Standardised matching fields: CSDs require the place of trade and transaction type in addition to existing matching fields. Subsequent ESMA Q&A responses have made both fields non-matching with POT only required to identify SME Growth Market trades.

Partial Settlement: CSDs are required to automatically partially settle any available securities prior to a buy-in. Through the settlement chain this information will be passed back to the buy-side.
Address: Penalties

Penalties: Cash penalties will be applied to all failing transactions across EU authorised CSDs

- The geographical location of the trading parties is not relevant
- All instruments eligible to settle at an EU CSD are in scope
- Instrument types in scope are: Equities/Debt/Funds/MM/Other CSD eligible
- All transaction types are in scope – noting that although Repo/SBL transactions <30 days are exempt from buy-in they remain in scope for cash penalties

- CSDs will calculate and apply penalties for each settlement instruction that fails to settle
- Applied daily from Intended Settlement Date (ISD) through to actual settlement date or buy-in date
- Consider the instrument, liquidity classification, price and transactions type
- Penalty rate will be applied to the daily closing price of the security

<table>
<thead>
<tr>
<th>Instrument Type</th>
<th>Rate (b.p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquid shares</td>
<td>1,0</td>
</tr>
<tr>
<td>Illiquid shares</td>
<td>0,5</td>
</tr>
<tr>
<td>Shares traded on SME growth markets</td>
<td>0,25</td>
</tr>
<tr>
<td>Bonds issued by</td>
<td></td>
</tr>
<tr>
<td>Sovereign issuer</td>
<td>0,10</td>
</tr>
<tr>
<td>Third country sovereign issuer</td>
<td></td>
</tr>
<tr>
<td>Local government authority</td>
<td></td>
</tr>
<tr>
<td>Central bank</td>
<td></td>
</tr>
<tr>
<td>Multilateral development bank</td>
<td></td>
</tr>
<tr>
<td>European Financial Stability Facility or the European Stability Mechanism</td>
<td></td>
</tr>
<tr>
<td>Other Bonds</td>
<td>0,20</td>
</tr>
<tr>
<td>Other bonds traded on SME growth markets</td>
<td>0,15</td>
</tr>
<tr>
<td>All other financial instruments not covered in points 1 to 6</td>
<td>0,5</td>
</tr>
<tr>
<td>Settlement fail due to a lack of cash</td>
<td></td>
</tr>
<tr>
<td>Official interest rate for overnight credit charged by the central bank issuing the settlement currency with a floor of 0 (zero)</td>
<td></td>
</tr>
</tbody>
</table>

- CSDs must provide daily reporting to their participants
- Participants will pass on details through the settlement chain
- Appeals process between CSD and its participant for technical considerations only
- The process for bi-lateral claims between failing parties is still to be determined

- Collected on at least a monthly basis by the CSD
  - From the failing CSD participant for redistribution to the receiving CSD participant
  - Penalties are aggregate per counterparty
  - No penalties are retained by the CSD
  - although the CSD may charge an administration fee
  - Penalties will be redistributed by the CSD once they have been fully collected
CSDR Settlement Discipline Buy-ins
Mandatory Buy-Ins: Implications for buy-side and sell-side

According to CSDR Level I Article 7(3), “[…] where a failing participant does not deliver the financial instruments….to the receiving participant within 4 business days after the intended settlement date […] a buy-in process shall be initiated.”

<table>
<thead>
<tr>
<th>Liquidity Classification</th>
<th>Extension Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquid securities</td>
<td>ISD+4</td>
</tr>
<tr>
<td>Illiquid securities and other instruments</td>
<td>ISD+7</td>
</tr>
<tr>
<td>SME growth markets</td>
<td>ISD+15</td>
</tr>
</tbody>
</table>

- A buy-in agent must be appointed by all trading parties to effect the buy-in

Pre Buy-in
- Intention should be to settle all trades on ISD to prevent buy-ins
- Extension period depends on the asset type and liquidity classification

Buy-in
- The failing to deliver party must place the trade on hold
- Information on formats for placing trades on hold are due from the CSDs, new fields on MT530 have been introduced for this purpose

Non-cleared trades
- The failing to receive party must initiate the buy-in through the appointed buy-in agent

Cleared trades
- The CCP must initiate the buy-in
- A CCP cannot be bought in
- In chains, a buy-in cannot be passed onto a CCP

Post Buy-in Execution
- Details of the buy-in must be reported against the original trade
- New buy-in trades must be linked to original trades
- Both parties must send cancellation instructions for the original trade upon successful settlement of the buy-in trade
- Compensation will be due to the failing to receive party to compensate for any loss suffered as a result of the buy-in
- If a buy-in is unsuccessful then cash compensation will be due instead
Monitor and Report: CSD obligations

Reporting to support and assess

Enhanced failed trade reporting

CSDs and participants

The CSD and all parties to the settlement chain must make their clients and therefore ultimately the trading parties aware of any settlement fails. Some participants are considering providing buy-in warnings.

Penalties

CSDs and participants

The CSD will calculate and report daily all penalties. Participants will be expected to pass this information through the settlement chain to their clients.

Buy-in success

Receiving trading parties

The receiving trading party must notify the CSD whether the buy-in was successful. The CSD will report the number and value of buy-ins to ESMA periodically.

Settlement Efficiency

CSDs

The CSDs will monitor settlement efficiency rates and report the top 10 lowest to the regulator.

Participants will be deemed to consistently and systematically fail trades where their settlement efficiency rate is significantly lower than the market average.
I trust you have found this brochure useful in detailing all the impacts buy-side firms can expect from CSDR.

When fully implemented, it could be argued this regulation will have had the biggest impact on the post-trade life cycle.

The aims and intentions of CSDR are positive in bringing increased settlement efficiency and harmonisation to ultimately ensure greater investor safety. This should be viewed as an opportunity for all firms working in the industry to review their processes and remove inefficiencies. Collaboration will be key to delivering more streamlined operational processes from end to end.

As a middle office outsourcer Securities Services will be there to guide you over the coming months and answer any questions you have about CSDR and the changes required. We will work in tandem with clients and industry counterparts as we finalise our Product solutions to ensure we and our clients have the optimum operating model in place to cope with and benefit from CSDR implementation.

Please contact me should you wish to discuss further.
Biographies

Director, Product Management

Paul Baybutt is one of the leading industry experts on CSDR. He has worked for HSBC for six years in the capacity of Senior Product Manager, Middle Office outsourcing. He has over 30 years experience of working in and working for buy-side operations where he has been instrumental in designing the Securities Services global operating model as well as the global model for a number of organisations including BNP Paribas and FFTW his two previous companies.

His vast experience has resulted in him playing a significant role in representing the European buy-side industry in determining best practice, implementing regulation and advising on buy-side needs. He is currently a member of the European Central Banks Advisory Group on Market Infrastructure, Securities and Collateral where he represents the UK Investment Management community. He is also on the ISITC Europe board, a member of the Irish Funds Forum Middle Office and Derivatives Working Group. He chairs the Investment Association’s Post Trade Committee and represents the European Fund and Asset Management Association (EFAMA) on the CSDR Industry Working Group.

Senior Product Manager

Isman Sadiq has joined the Middle Office Product team as a Senior Product Manager based in London.

Ish joined HSBC from State Street Global Advisors, where he was Head of European Shareholder Services looking after teams incorporating Transfer Agency, Client Dealing, Transaction Processing and Transitions.

Ish has over 30 years experience in a number of institutions across both the buy and sell side gaining in depth cross instrument knowledge across global markets. He has worked with premier market vendors to deliver global business change, particularly related to the Post Trade model. During this tenure he also built out teams in offshore jurisdictions providing the local subject matter expertise. He has represented his firm on a number of different industry forums particularly in the post trade capacity. He is currently developing Securities Services’ CSDR solutions.

Senior Product Analyst

Michael Inglis is a Senior Product Analyst for HSBC with 18 years service. Prior to joining Middle Office Product in 2018, Michael occupied various roles within Investment Operations, latterly a Senior Manager in Settlements.

Michael was the Service Delivery Lead for a highly successful transformation of Settlements Functions into Kuala Lumpur and Manila City Sites over an 18 month period, including establishment of the Settlement Support team in Edinburgh and helping shape the Investment Operations Governance Framework.

Since joining Product, Michael’s remit has included extending Middle Office services to new and existing clients, increasing Funds Trade Processing capabilities with focus on manual confirm automation, China Connect, Symphony initiatives, SWIFT gpi and CSDR.
References

Please see below links if you would like additional information on this topic:

CSDR Level I Text:  

CSDR Level II Text (RTS):  

ESMA Q&A:  

FCA Financial Instruments Transparency System:  
https://www.fca.org.uk/publication/systems-information/fca-fitrs-instructions_0.pdf

ESMA Financial Instruments Transparency System:  
https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_fitrs_files

AFME Recommendations for Partial Settlement:  

ESMA CSD Register:  
https://ecsda.eu/facts

List of European CSDs authorised under the CSDR:

HSBC Market Insights: HSBC Central Securities Depositories Regulation (CSDR) FAQs  
https://www.gbm.hsbc.com/insights/securities-services/csdr-frequently-asked-questions
Disclaimer
HSBC Bank Plc

This document is issued by HSBC Bank plc (“HSBC”). HSBC is authorised by the Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority (FCA) and the PRA and is a member of the HSBC Group of companies (“HSBC Group”).

HSBC has based this document on information obtained from sources it believes to be reliable but which have not been independently verified. Any charts and graphs included are from publicly available sources or proprietary data. Except in the case of fraudulent misrepresentation, no liability is accepted whatsoever for any direct, indirect or consequential loss arising from the use of this document. HSBC is under no obligation to keep current the information in this document. You are solely responsible for making your own independent appraisal of and investigations into the products, investments and transactions referred to in this document and you should not rely on any information in this document as constituting investment advice. Neither HSBC nor any of its affiliates are responsible for providing you with legal, tax or other specialist advice and you should make your own arrangements in respect of this accordingly. The issuance of and details contained in this document, which is not for public circulation, does not constitute an offer or solicitation for, or advice that you should enter into, the purchase or sale of any security, commodity or other investment product or investment agreement, or any other contract, agreement or structure whatsoever. This document is intended for the use of clients who are professional clients or eligible counterparties under the rules of the FCA only and is not intended for retail clients. This document is intended to be distributed in its entirety. Reproduction of this document, in whole or in part, or disclosure of any of its contents, without prior consent of HSBC or any associate, is prohibited. Unless governing law permits otherwise, you must contact a HSBC Group member in your home jurisdiction if you wish to use HSBC Group services in effecting a transaction in any investment mentioned in this document. Nothing herein excludes or restricts any duty or liability of HSBC to a customer under the Financial Services and Markets Act 2000 or the rules of the FCA.

This presentation is not a “financial promotion” within the scope of the rules of the Financial Conduct Authority. HSBC Bank plc is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered in England No. 14259

Registered Office: 8 Canada Square, London, E14 5HQ, United Kingdom

Member of the HSBC Group

For clarity this presentation contains information on the following products. Only those products marked as “Regulated” are regulated by the FCA or PRA.

- Custody- Regulated
- Securities Lending- Regulated
- Fund Admin- Not regulated
- Middle Office administration- Not regulated
- Middle Office dealing- Regulated
- Trustee and Fiduciary services- Regulated