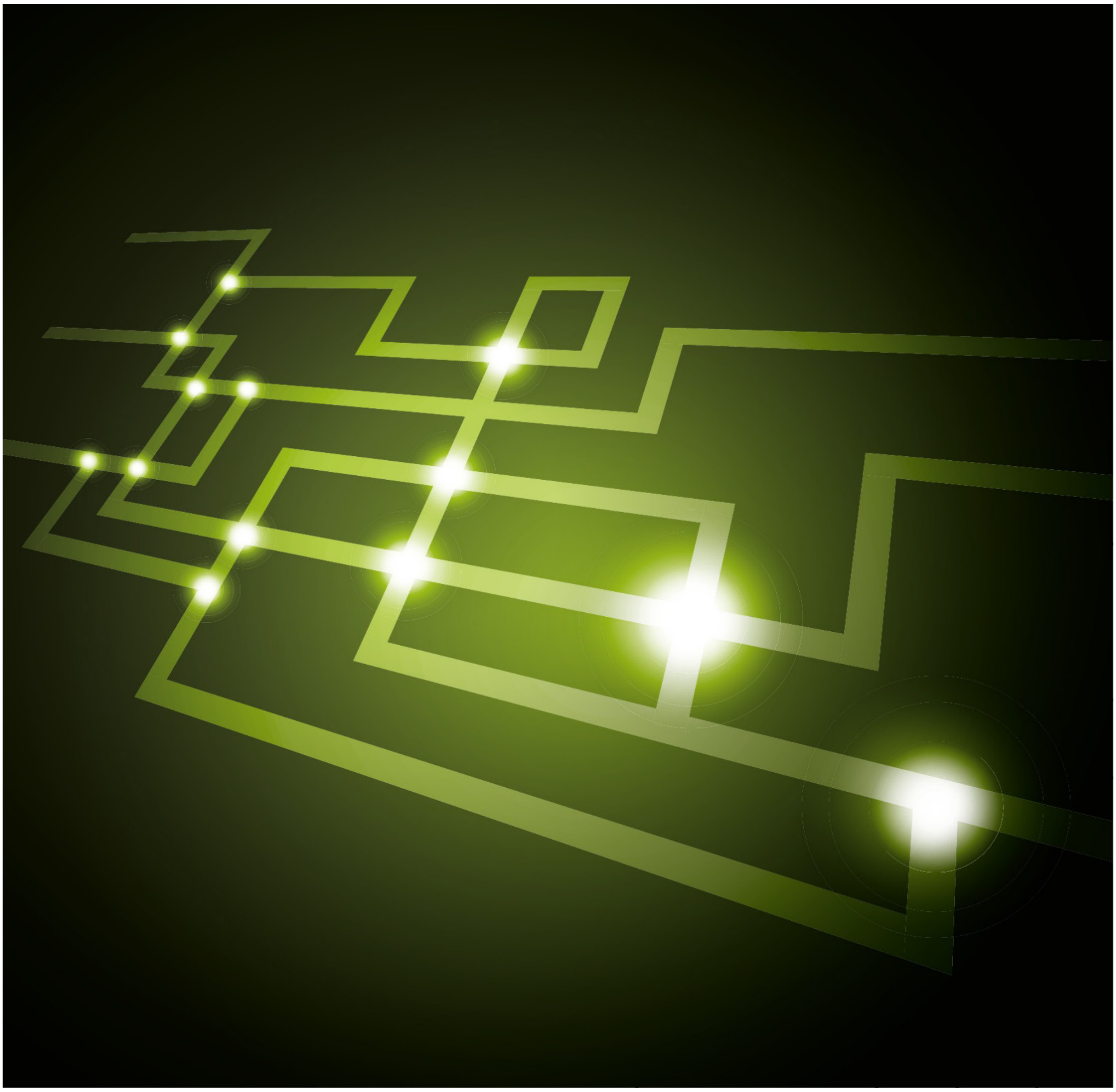
Finance for Europe

# Introduction to CDSR Settlement Discipline

September 2019



Association for Financial Markets in Europe
www.afme.eu

## What is CSDR Settlement Discipline?

The Central Securities Depository Regulation (CSDR) is the latest step in establishing an EU-wide harmonised regulatory framework for financial market infrastructures and promoting safety and stability in financial markets. The regulation covers a wide range of requirements across its phased implementation timeline, the last of which is the Settlement Discipline Regime which comes into force in Sep 2020.

The Settlement Discipline Regime applies to all transactions in European Settlement systems and consists of both a Cash Penalty for late settlement (applied by CSDs) and Mandatory Buy-ins (to be performed by the trading parties).


## Who is impacted?

All parties in the settlement chain involved in transactions in European markets are potentially impacted, including where the trading parties are not located in Europe. There are regulatory obligations for both the receiving and delivering parties in a failing transaction. This means that all market participants will need to prepare for CSDR, even those with no failing deliveries.

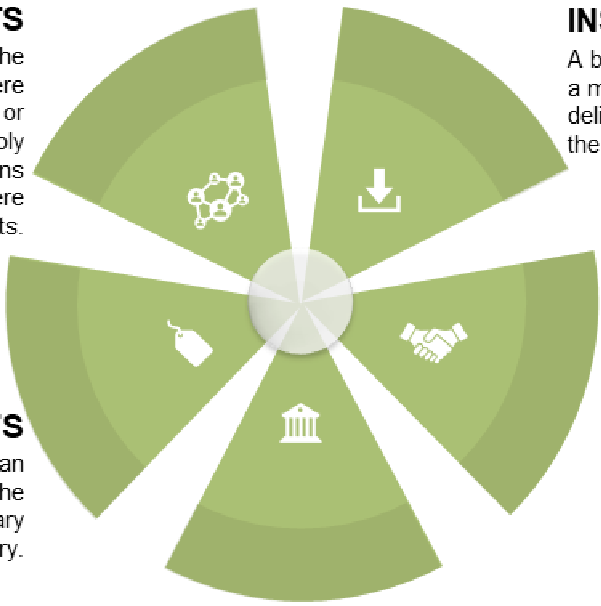
## What is the Scope?

**PARTICIPANTS**

The geographical location of the trading parties is not relevant. There is no exemption for non-EU clients or investment firms, who must comply with CSD regulation for instructions settled at an EU CSD; even where they are indirect CSD participants.

**INSTRUCTIONS**

A buy-in can only be initiated on a matched instruction, where the delivering party is responsible for the failure of the trade.



**TRANSACTIONS**

Some transaction types are exempt from buy-in process – e.g. Repo or SBL transactions under 30 days. However, these are still in scope for cash penalties

**INSTRUMENTS**

All instruments eligible to settle at an EU CSD are in scope, with the exception of shares where the primary trading venue is in a third-country.

**CSDs**

ESMA will maintain a register of authorised CSDs who will be in scope of the regulation.

## Penalties

**Cash penalties** will be applied to all failing matched transactions.

These will be calculated at the end of each business day where an instruction fails to settle, from intended settlement date (ISD) until actual settlement date. The calculation is done by the CSD and reported to its participants on a daily basis. Penalties will also be applied to an instruction that is matched after its intended settlement date.

Daily penalty rates range from **0.1 basis points** for SSA Bonds to **1.0 basis points** for liquid shares. Settlement failures due to lack of cash will be charged based on official interest rates. A full list of the applicable penalty rates is included in the Annex of the Delegated Act on Cash Penalties.

Penalties will be collected on at least a monthly basis by the CSD from the failing CSD participant for redistribution to the receiving CSD participant.

No penalties are retained by the CSD, although the CSD may charge an administration fee.

## Buy-ins

A **mandatory buy-in** procedure will be introduced for transactions still failing at the end of the Extension Period.

The Extension Period is determined by the instrument traded: **ISD+4** for liquid shares; **ISD+7** for other financial instruments; **ISD+15** for transactions on an SME growth market.

The responsibility for initiating the buy-in is with the receiving party. For cleared trades, the buy-in is effected by the CCP. For non-cleared trades, the buy-in is effected by the receiving trading venue member, or the receiving trading party if traded off-exchange.

Buy-in mechanisms provide a buyer of securities the contractual right to source the securities elsewhere (usually for guaranteed delivery). The failing sale will be offset against the buy in and any costs passed to the failing seller.

In the event that the buy-in or reference price is lower than the original transaction price, the payment of the difference is "deemed paid".

If the buy-in is not completed within the Extension Period, it can be deferred once. If still unsuccessful, it will be resolved through cash compensation. An example of a buy-in timeline for a liquid share traded OTC is illustrated on Page 4.

## Important links

CSDR Level 1: bit.ly/2KVupgm

Delegated Act on Cash Penalties: bit.ly/2KEwXka

CSDR Level 2 RTS on Settlement Discipline: bit.ly/2HfXUIV

ESMA Q&A on CSDR: bit.ly/2mDiBVn

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# Lifecycle of a Failing Trade under CSDR

*Based on a liquid share with a T+2 settlement cycle

**TD** — **Trade Date**
Investment Firms and their clients must comply with measures introduced by CSDR mandating the timely allocation and confirmation of transactions.

**TD+1**

**ISD** — **Intended Settlement Date**
Any transactions not settled by the end of ISD will be in scope for cash penalties of 1 basis point per day for liquid shares.

**ISD+1** — **Extension Period**
For liquid shares the extension period is 4 business days. During this time, failing transactions will continue to accrue daily penalties, encouraging the failing trading party to make delivery.
On the final day of the extension period, the receiving party is mandated to accept any partial delivery offered.

**ISD+2**

**ISD+3**

**ISD+4**

**ISD+5** — **Buy-in Period**
Following the expiry of the Extension Period, the receiving trading party is mandated to verify if a buy-in is possible, and initiate a buy-in by appointing a Buy-in Agent. For liquid shares, the window to execute and settle the buy-in is 4 business days.

**ISD+6**

**ISD+7**

**ISD+8**

**ISD+9** — **Cash Compensation (post Buy-in Period)**
If the buy-in is not successfully completed and the receiving trading party chooses not to defer, the failing trading party pays cash compensation to the receiving trading party.

**ISD+9** — **Deferral Period (OPTIONAL)**
In cases where the buy-in is not successfully completed within the buy-in period, the receiving trading party has the option to defer the buy-in, allowing another window of 4 business days to reattempt the buy-in.

**ISD+10**

**ISD+11**

**ISD+12**

**ISD+13** — **Cash Compensation (post Deferral Period)**
If the buy-in is not successfully completed, the failing trading party pays cash compensation to the receiving trading party.