

# CSDR – Settlement Discipline Regime - February 2022

Jan 27, 2022

## **Background**

On September 13, 2018, a delegated regulation setting out regulatory technical standards (RTS) on settlement discipline, was published in the Official Journal of the European Union (EU). Under the current timetable, this delegated regulation will enter into force on February 1, 2022.

The Central Securities Depositories Regulation (CSDR) rules on the settlement discipline regime that introduces several measures to prevent settlement fails by ensuring that all transaction details are provided to facilitate settlement, as well as further incentivising timely settlement through cash penalty fines and buy-ins.

In addition, CSDs are required to provide functionality to participants to ensure harmonisation and automation of settlement processes across all European Economic Area (EEA) markets to improve settlement efficiency.

This document seeks to address some of the Questions clients may have, and to assist their understanding of the CSDR settlement discipline regime, how it will impact them, and how Hobart is planning to respond.

## **Introduction**

### ***1. What is the Central Securities Depositories Regulation (CSDR) settlement discipline regime?***

The CSDR settlement discipline regime covers two main sets of measures:

- a. measures to prevent settlement fails by improving matching and settlement rates, and
- b. measures to address settlement fails: cash penalties and mandatory buy-ins (postponed until further notice)

### ***2. Who is affected by CSDR settlement discipline regime?***

All parties in the settlement chain involved in transactions in securities settling via a European Union (EU) Central Securities Depository (CSD) will be affected by the settlement discipline regime, including where the trading parties are not located in the European Economic Area (EEA). The regulatory obligations will affect both the receiving and delivering parties in a given failing transaction.

### *3. When will the settlement discipline regime enter into force?*

The new settlement discipline regime will take effect on February 1, 2022. Clients will not need to make any changes to their existing legal agreement.

## **CSD functionality to assist matching and settlement.**

### ***Tolerance matching – what does the regulation require?***

CSDs will need to have a functionality to allow matching even if the cash amounts on the two settlement instructions differ. In such a case, matching will occur providing that the difference in cash amounts is not greater than a standard tolerance level. There will be two bands of tolerance:

- EUR 2 for up to EUR 100,000 or currency equivalent
- EUR 25 for over 100,000 or currency equivalent

Any settlement instructions with a broker cash amount above these tolerances will not match until one party amends their instruction to within the tolerance level.

### ***What is the impact to clients?***

Clients will not need to make any changes to their existing settlement instruction process

### ***Bilateral cancellation – what does the regulation require?***

CSDs are obliged to operate a bilateral cancellation facility that requires participants to bilaterally cancel matched settlement instructions.

Most EU/EEA CSDs currently operate with bilateral cancellation and those remaining unilateral cancellation markets will be updated to follow the new process.

### ***What is the impact to clients?***

Clients will need to ensure that both parties to a matched settlement instruction will need to instruct a cancellation of the settlement instruction in order to prevent the transaction from settling.

### ***Partial settlement – what does the regulation require?***

CSDs are required to provide participants with functionality to partially settle transactions.

### ***What is the impact to clients?***

Hobart will endeavour to align with best practice and offer auto-partial settlement to the extent possible.

## Measures to address settlement fails functionality

### *What does the regulation require?*

CSDs are required to establish penalty mechanisms for late matching and failed settlement and will debit failing CSD participants and credit the non-failing CSD participant.

### *Which type of instructions will be subject to cash penalties?*

All settlement instructions, free or against payment, settling at an EU/EEA CSD, which are matched on or after their Intended Settlement Date (ISD), and failing to settle on and after their ISD.

### *Which instructions are not subject to cash penalties?*

- Settlement transactions that do not represent "transfer orders" according to the [Settlement Finality Directive](#);
- Corporate action transactions on stocks;

### *What are the types of cash penalties?*

- a. Late Matching Fail Penalty (LMFP); penalty that applies due to the matching taking place after the ISD.
- b. Settlement Fail Penalty (SEFP); penalty that applies due to the non-settlement of a matched transaction on or after its ISD.

### *What instruments are in-scope for cash penalties?*

All transferable securities are in scope where admitted for trading or traded on an EU/EEA trading venue or Cleared by an EU/EEA CCP as follows:

- i. transferable securities as defined in point (a) of Article 4(1)(44) of Directive 2014/65/EU;
  - ii. sovereign debt as defined in Article 4(1)(61) of Directive 2014/65/EU;
  - iii. transferable securities as defined in point (b) of Article 4(1)(44) of Directive 2014/65/EU, other than sovereign debt referred to in point (ii); transferable securities as defined in point (c) of Article 4(1)(44) of Directive 2014/65/EU;
  - iv. exchange-traded funds (ETFs);
  - v. units in collective investment undertakings, other than ETFs;
- i. money-market instruments, other than sovereign debt referred to in point (ii);
  - ii. emission allowances;
  - iii. other financial instruments

### *What is the difference between a late matched and settlement fail trade?*

A late matched trade is any trade settling at an EU/EEA CSD that matches after intended settlement date. The last party to match the trade, post settlement date, is liable for the late matching fail

penalty.

A settlement fail is any matched trade settling at an EU/EEA CSD that has not settled on the intended settlement date (ISD) where the reason for failure is either due to a lack of securities or cash.

### ***What are the Settlement fail cash penalty rates?***

The daily cash penalty rates use the basis points in the following table:

<b>Reason for Failure</b>	<b>Type of security</b>	<b>Liquidity indicator</b>	<b>SME Growth Market</b>	<b>Penalty rate (in bps)</b>
<b>Lack of securities</b>	Share	Liquid	No	1.00
		Illiquid		0.50
		N/A	Yes	0.25
	Sovereign debt		N/A	0.10
	Corporate debt		No	0.20
	Money-Market Instruments		Yes	0.15
Other Instruments (including Exchange Traded Funds, Units in collective investment undertakings, emission allowance, etc.)		No	0.50	
		Yes	0.25	
<b>Lack of cash</b>	N/A	N/A	N/A	Official interest rate for overnight credit charged by the central bank issuing the settlement currency with a floor of 0

## ***How are cash penalties calculated?***

Cash penalties are calculated daily and per day as from the ISD until the actual settlement or cancellation date of the instruction:

- For Late Matching Fail Penalty (LMFP): penalties apply retroactively from the ISD until the actual matching date.
- For Settlement Fail Penalty (SEFP): once the instruction is matched, penalties apply earliest from the ISD or the matching date to the date of actual settlement or cancellation of the instruction.

The formulas to calculate the penalty imposed by a Settlement Fail Penalty (SEFP) are the following:

a. For a failing DVP, DF or RF Settlement Instruction:

$$\text{SEFP} = \text{Security Penalty Rate} * \text{Reference Price} * \text{Quantity}$$

b. For a failing RVP Settlement Instruction:

$$\text{SEFP} = \text{Cash Discount Penalty Rate} * \text{Reference Price} * \text{Quantity}$$

The same penalty calculation method applies to Late Matching Penalties and Settlement Fail Penalties.

## ***Will Hobart pass on cash penalties to its clients?***

Yes, where applicable, Hobart intends to pass on the Late Matching and Settlement Fail Penalties to its clients.