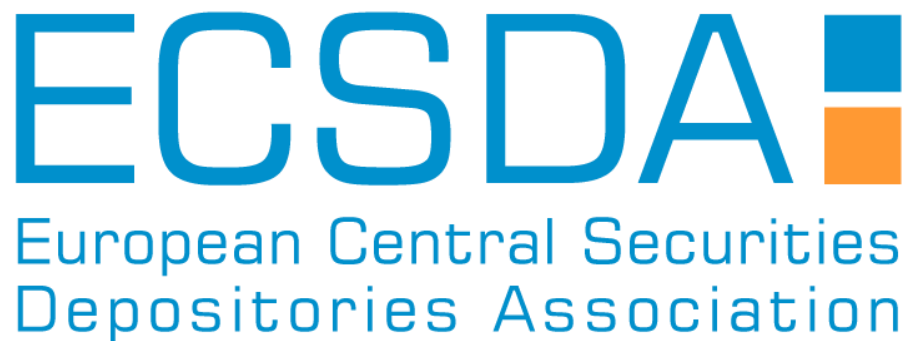


The EU CSD Regulation: Settlement discipline and other challenges



SMPG meeting,
La Hulpe, 15 April 2015

Alexander Westphal

Overview

1	Impact on CSDs
2	An EU regime for settlement discipline
3	Other challenges for the market
4	Next steps

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Impact on CSDs

- **A set of harmonised rules for EU CSDs**
 - ✓ Single process for CSD authorisation & supervision
 - ✓ Harmonised governance and transparency provisions
 - ✓ Common prudential & minimum capital requirements
 - ✓ An EU “passport” for CSDs
 - ✓ Non-discriminatory access

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Situation today

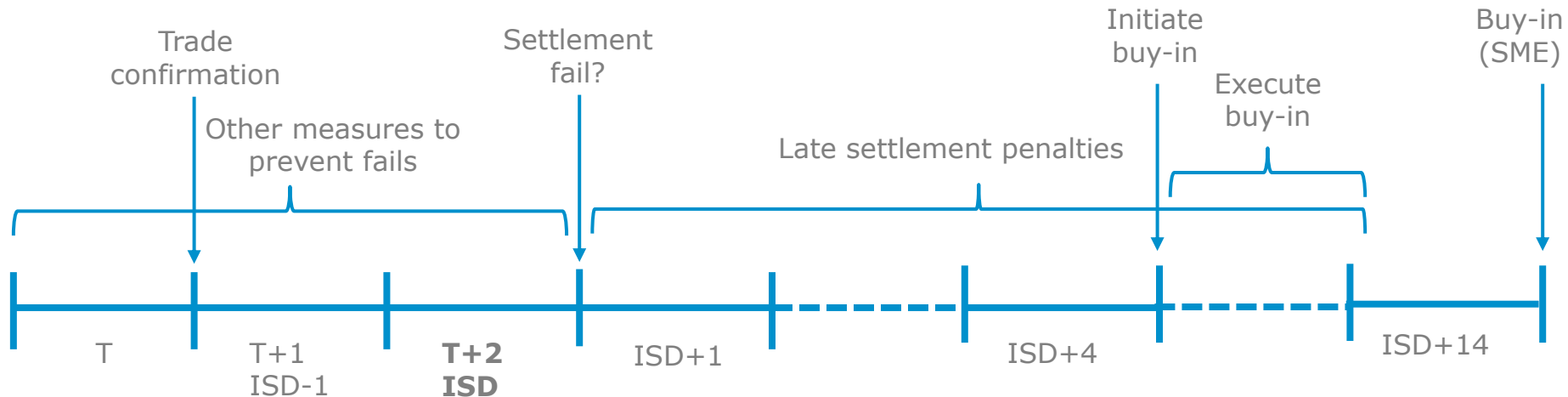
- **Already high settlement efficiency in Europe:**

- ✓ Average settlement efficiency rate: 98.9% on ISD and 99.5% on ISD+1 (value terms) (ECSDA report 09/2012)
- ✓ But some differences across markets

- **Current settlement discipline regimes**

- ✓ Not all CSDs charge late settlement penalties (12 out of 20)
- ✓ If they do, mostly flat fees, but regimes differ substantially
- ✓ Some exemptions, performance thresholds
- ✓ CSDs generally not involved in buy-ins

CSDR settlement discipline: overview



▪ CSDR covers all stages of the trade life cycle

- ✓ Trade confirmation
- ✓ Other measures to prevent fails (matching etc.)
- ✓ Late settlement penalties and buy-ins
- ✓ Fails reporting

Preventing settlement fails

- **Trading venues to ensure same day confirmation**
- **Measures by investment firms to limit settlement fails**
 - ✓ Written confirmation and account allocation
- **CSD measures to facilitate timely settlement**
 - ✓ CSDs to promote automation and STP
 - ✓ Required functionalities: recycling, H/R, partial settlement
 - ✓ Compulsory & continuous matching
 - ✓ Proposed list of standardised (mandatory) matching fields

Fails monitoring and reporting

- **A detailed framework for fails monitoring & reporting**
 - ✓ Harmonised template and methodology for reporting...
 - ✓ ... to authorities, participants and public disclosure
 - ✓ Detailed proposals on information items and codes
- **Inconsistencies with ISO standards**
 - ✓ Closely linked to rules on CSD record-keeping
 - ✓ Helpful SWIFT mapping to identify inconsistencies

Late settlement penalties

- **A deterrent penalty mechanism for settlement fails:**
 - ✓ Including daily, ad-valorem cash penalties
 - ✓ Proposed penalty rates differ across instruments, ranging from 0.25 bp to 1 bp
 - ✓ Mark-to-market approach for reference prices to cover both DvP and FoP instructions
- **Penalty to be passed on through the chain:**
 - ✓ Penalties to be redistributed to the suffering participant
 - ✓ Collection and redistribution of fines on a monthly basis
 - ✓ CCPs exempt from penalties

Late settlement penalties

- **Some open questions remain, including:**
 - ✓ What is sufficiently deterrent?
 - ✓ Are the proposed rates and categories appropriate?
 - ✓ How to take liquidity into account?
 - ✓ Will there be a central database of securities in scope?
 - ✓ How to ensure the use of consistent reference prices across CSDs?
 - ✓ How to accommodate the CCP exemption?

Buy-ins

- **Buy-ins will be mandatory:**
 - ✓ Mandatory buy-ins after ISD+4 (ISD+15 for SME)
 - ✓ Applies to all financial instruments, but exemption for short-term repos and SLB
 - ✓ If buy-in fails, cash compensation or deferral
- **Questions remain around the buy-in process:**
 - ✓ For CCP-cleared transactions, buy-in executed by CCP
 - ✓ Otherwise obligation for trading venue or CSD to have buy-in obligation in internal rules... but who executes?
 - ✓ In principle CSD should not be involved... but how to enforce?

Key concerns

- **The potential market impact is substantial:**
 - ✓ ECSDA estimates based on fails data from 17 CSDs:
 - ❖ **Buy-ins:** over 150,000/month, worth around €214 billion
 - ❖ **Penalties:** over €183 million/month or €9 million a day
 - ✓ In addition: adverse impact on liquidity and spreads?
 - ✓ A proper impact assessment of the rules is still pending
- **Timing of implementation needs to be adjusted**
 - ✓ Sufficient transition period important given implementation challenges and T2S timeline

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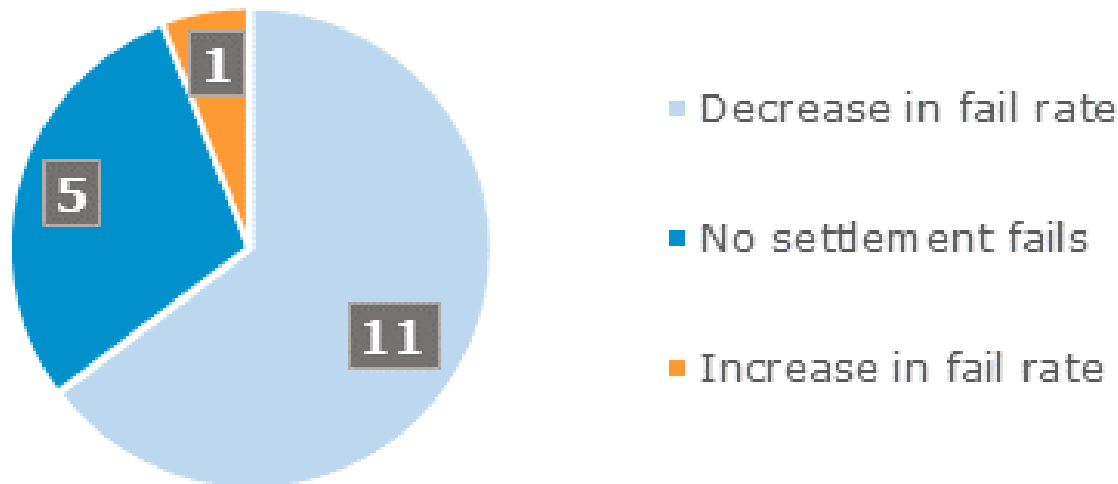
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T+2

- **CSDR requirement to move to T+2**
 - ✓ By 1 Jan 2015 at the latest (or 2016 by exception)
 - ✓ Applies to trades “executed on trading venues”
 - ✓ Close industry coordination in preparation for the move
- **The successful transition took place on 6 Oct 2014:**
 - ✓ “Big bang” migration of 29 European markets
 - ✓ No negative impact on settlement efficiency
 - ✓ More markets to follow...

- **ECSDA fails data from 17 markets illustrates the smooth transition**

Proportion of failed instructions at CSDs on 8-10 October
(compared with the previous week)

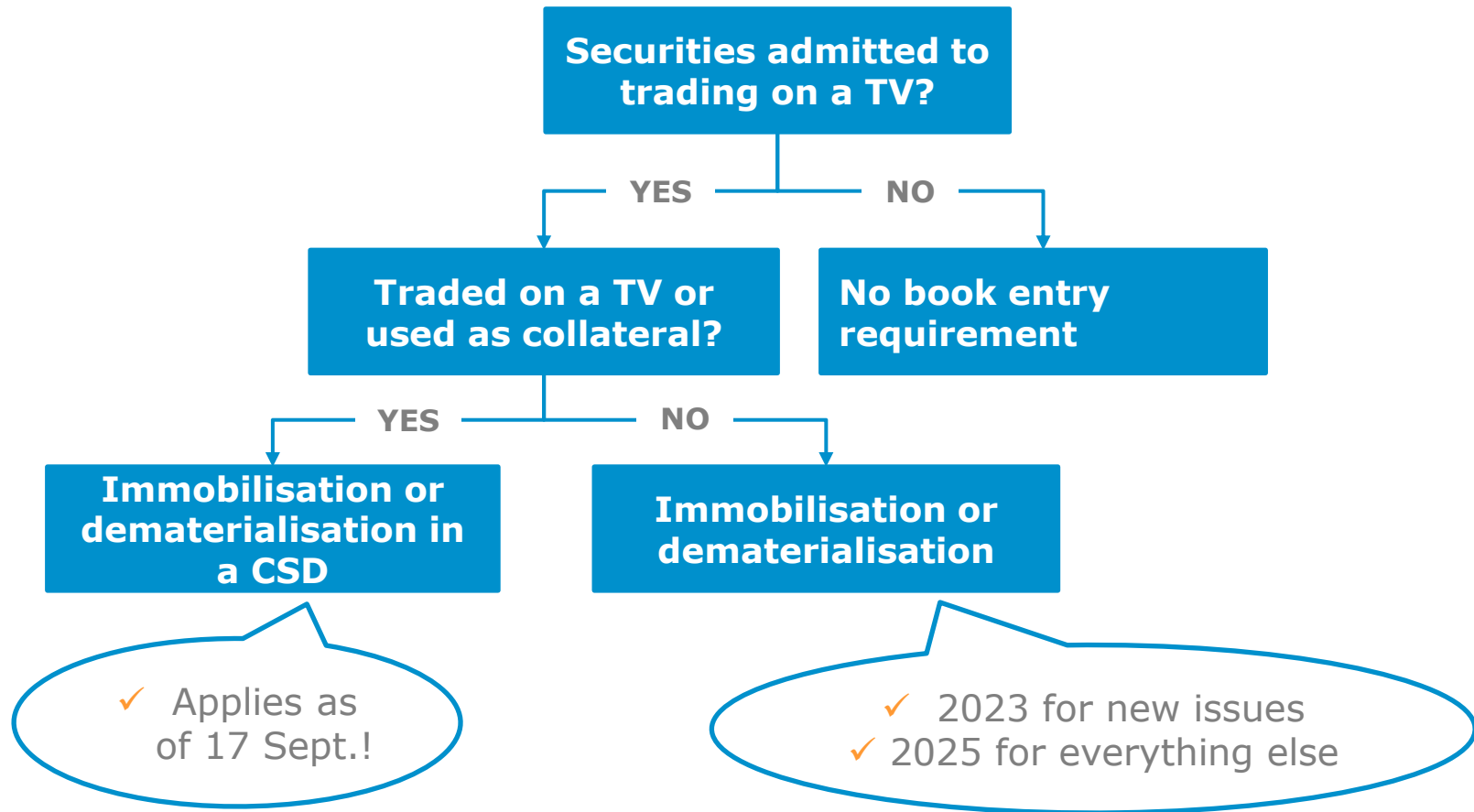


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Book Entry Requirement

- The end of paper securities...



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Protection of client securities

- **New rules on account segregation**

- ✓ CSD participants must offer a choice to their clients between omnibus & individual client segregation at CSD level
- ✓ Public disclosure of the costs & risks associated with each option (including legal implications in insolvency)
- ✓ Questions remain around implementation and enforcement of the rules



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"Banking" services

- **Commercial bank money settlement...**

- ✓ only allowed if CeBM is not "practical and available"
- ✓ requires a special authorisation under CSDR art.54:
 - Either CSD itself obtains authorisation;
 - Or designates a separate settlement bank

- **In both cases, strict prudential rules apply**

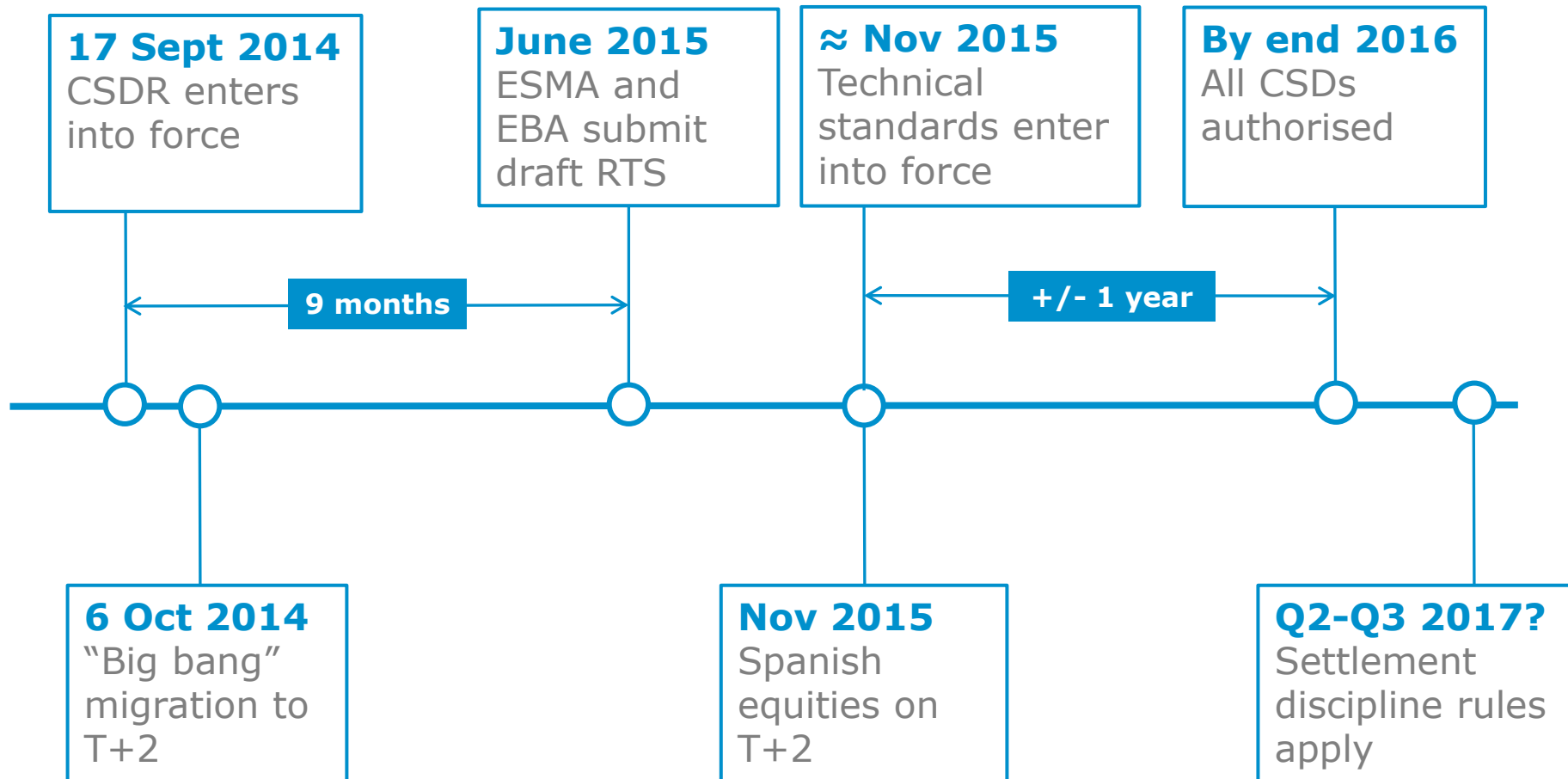
- ✓ Limited banking license (Section C of Annex)
- ✓ Full compliance with banking legislation + additional capital surcharge + extra rules on credit & liquidity risks

- **Exception for low CoBM volumes (max. €2.5 bn/year)**

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CSDR indicative timeline



Thank you!



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