



ECSDA CSDR Penalties Framework

Industry Workshop

Frankfurt

Monday 18 February

Introduction

- The “ECSDA CSDR Settlement Fails Penalties Framework” is the **effort of compliance with the regulation and harmonisation** of settlement penalties mechanism across CSDs subject to CSDR or regulation alike
- The Framework constitutes a **market practice** for CSDs and focuses on the settlement fails **penalties-related aspects** of the CSDR settlement discipline regime
- The Framework is shared with the relevant stakeholders with the aim of:
 - Sharing **our current thinking and challenges**, and
 - Exchange with main stakeholders for **further enhancement of the Framework**.

Introduction

ECSDA sets the Framework for all CSDs subject to CSDR-like rules

Participation includes:

EU CSDs (subject to CSDR)

EEA CSDs (subject to incorporated laws similar to CSDR)

EU third country CSDs aiming at providing services and being recognised in the EU

ECSDA framework aims at advising the CSDs on how to address the totality of their CSDR SDR obligations

- Builds upon CSDR and draft standards
- Checks endorsement of T2S CSDR TF work by non-T2S CSDs
- Builds up further considerations upon it and develops ideas on areas out of CSDR TF scope
- Aims at coherence of approaches between all CSDs in their different roles for cross-CSD activity

Introduction

Key challenges

- **Key challenges**, mainly in relation to cross-CSD settlement fails situations:
 - **Collection and distribution:**
 - › **Conversion into currencies**
 - › **Messaging**
 - › **Payment methods (direct debit, PFOD, other)**
 - › **Payment process (timing, completeness...)**
 - **Business days alignment for detection, reporting, appeal and payment**

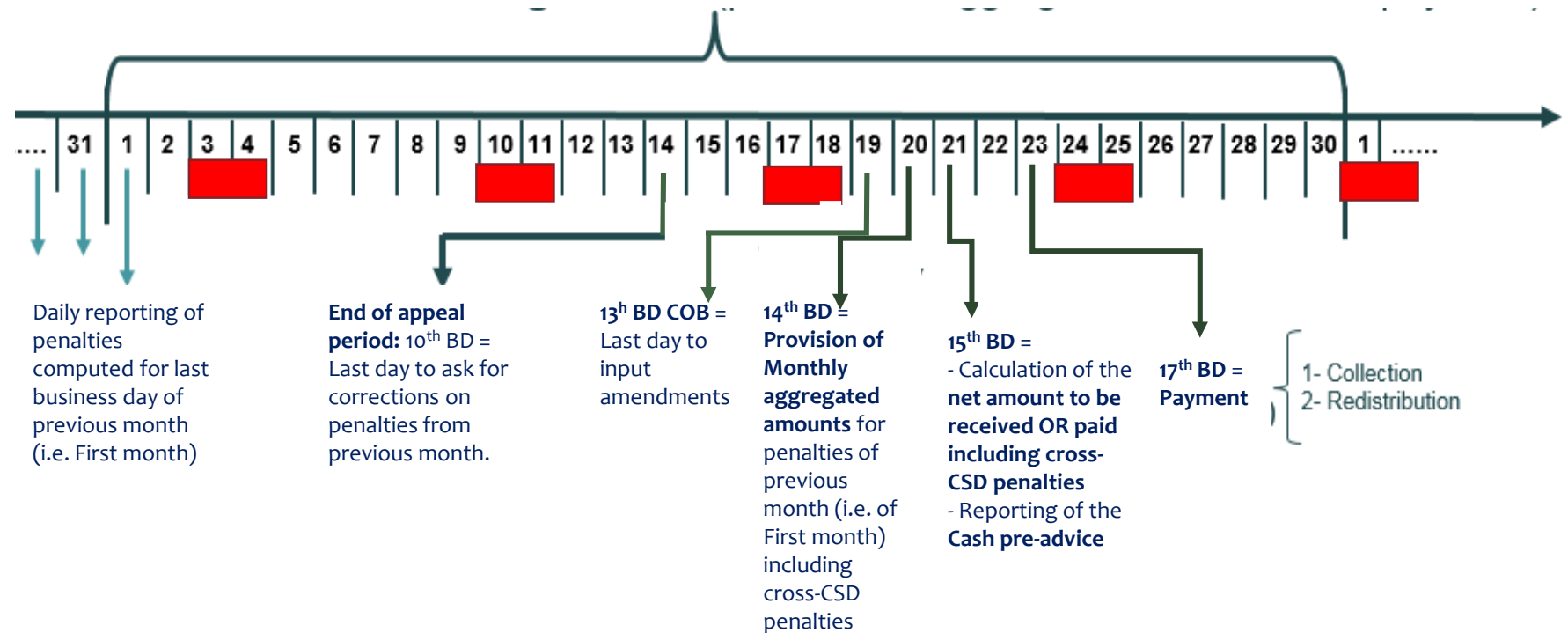
2. Penalties Lifecycle and Business Days Calendar

- Business Days to be applied:
 - The CSD's own settlement calendar;
 - The penalties Calculating-CSD's settlement calendar (for cross-CSD only);
 - The payment system calendar of the relevant currency (for DVP only).
- Business days are those days on which an instruction can settle in the own CSD and the other CSD's settlement system and (in case of settlement versus payment, when the payment is executed outside the CSD system) the payment system applicable to the relevant currency (“opening days”).

ECSDA intends to provide a yearly ‘Penalties calendar’ indicating the closing dates for settlement and payment systems that shall be considered by all CSDs subject to SDR.

2. Penalties Lifecycle and Business Days Calendar

Following MONTH (provision of aggregated amounts and payment)



2. Penalties Lifecycle and Business Days Calendar

- **Daily Reporting**
 - On new, amended, removed or re-included penalties during the day.
 - At latest until noon (12:00 p.m. CET) on the following business day.
- **Monthly Appeal Period**
 - Appeals apply exceptionally and must be lodged by CSD participants latest until the 10th BD (included) of the following month.
- **Monthly aggregated amounts**
 - Provided on the 14th BD of the following month
 - For each party, per currency and counterparty
 - Sum of all the cash penalties that this party can be expecting to be credited or debited by a counterparty.
- **Monthly payment (collection & re-distribution)**
 - On the 17th BD of the following month
 - Various payment options are discussed (cash transfers, PFOD instructions or use of a payment bank; see Agenda item 10. “Collection & Redistribution” of this presentation).

3. Penalties Scope - Instruments

CSD-eligible MiFID/R financial instruments that are

- transferable securities [i.e. equity- and bond- (like) instruments (including ETFs) and giving a right to buy or sell any of those], money-market instruments, UCITS and emission allowances;
- admitted to trading or traded on an EU trading venue (see **ESMA FIRDS database**); or
- cleared (or eligible for clearing) by an EU CCP
- excluding **shares** when their principal trading venue is located in a Third Country (refers to EU **Short Selling Regulation**)

All CSDs need to individually derive the information, if an ISIN is actually in scope of SDR.

Note:

- ESMA FIRDS database contains EU and non-EU issued securities.
- The same approach is expected to be applied by CCPs and Trading parties for buy-in initiation.

3. Penalties Scope - Instructions

Settlement instructions, i.e. “Transfer orders” according to the second indent of point (i) of Article 2 of Directive 98/26/EC [Settlement Finality Directive], that are

- to be settled free of or against/ with payment, and
- matched (prior, on or after their Intended Settlement Date (ISD)), and
- failing to settle on and after their ISD, when
- the actual settlement is taking place in a CSD subject to CSDR (various “actual place of settlement” scenarios apply)

Exemptions (ESMA to confirm):

- Redemptions (ISO Transaction Code equals REDM);
- Corporate actions on stock (CORP);
- Technical instructions, e.g. T2S automatic realignments;
- T2S Settlement restrictions

4. Identification of the party to be penalised

- **Late Matching Fail Penalty (LMFP)**
 - To be applied on any instruction which is matched after the relevant cut-off of its ISD, for the business day when it is matched and (retroactively) for each past business day on that it failed to settle.
 - Applied to the participant who was last to enter or modify the relevant settlement instruction
 - Already matched instructions: to charge either the instructing party or the delivering party
- **Settlement Fail Penalty (SEFP)**
 - Any settlement instruction, being in scope of the penalties calculation, that
 - i) is matched before the relevant cut-off of a given business day; and
 - ii) has reached its ISD; and
 - iii) fails to settle on that ISD or on the day it is matched (late, after ISD) and after, including instructions that are “on hold”.
 - A settlement instruction that “fails to settle on that ISD” must be understood as a settlement instruction that is not cancelled and remaining to be settled, fully or partially, by the time of the end of processing of the relevant CSD settlement cut-off time.
 - Penalties apply for each business day the instruction is failing to settle.

5. Reference/ Static data required for penalty calculations

Various data needs to be collected and maintained by each CSD prior penalties can be calculated daily:

- (actual and historic) daily MIFID/R reference prices per ISIN in scope of SDR
- Liquidity indicator (for shares; use ESMA FITRS database)
- Financial Instrument Type (use CFI code mapping)
- Penalty rate per Financial Instrument Type (as published by ESMA in 2017)
- MICs of SME growth markets (use ESMA register)
- Central Bank discount rate (of ECB and other Central Banks)

Challenges:

- No single central database covering all the above elements exists
- ESMA to clarify how the MIFID trading venue “with the highest turnover” shall be identified
- Absence of a single European price feed or source for all CSDs, i.e. CSDs source prices via their data vendors; hence, prices will not be reported/ published by CSDs due to vendor contracts limitations

6. Penalties Currencies Conversion needs

The currency to be used for the penalties is at the discretion of the CSD; however, for DVP instructions, the currency of the cash leg should be applied. For FOP fails, the imposed penalty amount will be calculated by CSDs in:

- either the currency of the underlying security if the instrument is quoted in nominal or per cent (usually Fixed Income instruments); or
- the currency of the daily reference price if the underlying security is quoted in units (usually shares)
- This may lead to FX conversion needs when a CSD does not support payments in the reference price currency (CSDs to use FX rates from ECB or other Central Banks)
- CSD participants may be required to arrange FX transactions in the payment month

Challenges:

- For cross-CSD settlement fails, only, challenges refer to penalties that are calculated and to be paid in a currency not eligible at the Investor CSD or settlement platform (e.g. T2S) - no solution could yet be found, ESCDA discussion continues. See as well Agenda item 10. “Collection & Redistribution”.

7. Calculation Methods of the Cash Penalties

Instruction types	Failure caused by	Formula to apply
Delivery Versus Payment Delivery Free of Payment Receipt Free of Payment	Lack of securities	Security Penalty Rate*Reference Price*Quantity
Receipt Versus Payment	Lack of cash	Cash Discount Penalty Rate* Reference Price* Quantity
Receipt Versus Payment already matched ⁽¹⁾	Lack of securities	Security Penalty Rate * Reference Price* Quantity
Debit Payment Free Of Delivery Credit Payment Free Of Delivery	Lack of cash	Cash Discount Penalty Rate* Amount
Delivery With Payment Receipt With Payment	Lack of securities + Lack of cash	Security Penalty Rate * Reference Price * Quantity + Cash Discount Penalty Rate * Amount

⁽¹⁾Specific to the LMFP

7. Calculation Methods of the Cash Penalties

- Daily
 - Penalties per failing transaction on that day (details of the calculation of the penalties included)
 - Bilateral net amount per CSD, per counterparty and per currency
 - Sum of all the penalties that this party is entitled to receive from a given counterparty in a CSD - Sum of all the penalties that are imposed to the party and to be paid to the same counterparty in the same CSD → a credit OR a debit.
- Monthly
 - Bilateral net amounts computed for all the business days of the previous month per currency and party against each of its counterparties.
 - Sum of all the penalties of the previous month in one currency, that the party is entitled to receive from a given counterparty - Sum of all the penalties of the previous month, in the same currency, and that were imposed to the party and to be paid to the same counterparty → a credit OR a debit.
 - Monthly amount to be paid or to be received (net amount per currency & party)
 - Sum of all the net bilateral amounts in the relevant currency, that the party is entitled to receive for all counterparties - sum of all the net bilateral amounts in the relevant currency and that were imposed to the party and for all counterparties.
- Note:
 - special treatment of CCP instructions (see Agenda item 12 “Miscellaneous” of this presentation)

WORKING ASSUMPTION: A single amount will result from this calculation that will either be an amount due by the party (i.e. to be paid by the party), or an amount to be received by the party.

8. Changes to previously calculated penalties

- Removal of existing penalties
 - CSDs may remove an already computed and reported penalty (i.e. set the penalty amount to “zero”, e.g. due to settlement suspension).
 - Status “removed” + standard removal code + detailed description of the reason.
- Re-inclusion of a previously removed penalty
 - CSDs may re-include already removed penalties.
 - Penalty amount needs to be re-calculated as it may have changed.
 - Status “active” + standard re-introduction code (to both parties).
- Re-allocation of an existing penalty
 - When the penalised party is not the real defaulting one.
 - Penalty amount needs to be re-calculated as a different formula may be used.
 - Status “removed” + standard re-allocation code for the non failing party.
 - Status “active” + standard re-allocation code for the real failing party.
- Update of existing penalties
 - In case of changes in the reference data (price of ISIN, liquidity, rate...)
 - New updated amount and values + Reason code “Updated”.

9. Cross-CSD Settlement Fails

- Identification of the penalty calculation responsibility of a CSD via a “place of actual settlement concept”:
 - The various scenarios consider whether or not a CSD in the settlement chain is actually subject to CSDR and which CSD is responsible for the calculation, reporting and/ or collection/ redistribution of penalty amounts, incl. T2S settlement.
 - the CSD where matching and settlement is ultimately taking place (i.e. where settlement finality is reached) is responsible for calculating the penalties (“Calculating CSD”) and report them to its underlying participants (that may as well be CSDs) for processing and forwarding the reporting to their underlying participants and triggering the actual collection and redistribution of the monthly penalty amounts.
 - As a result, only one CSD calculates the penalties.
- Note:
 - The settlement scenarios have been discussed with ESMA (and are as well part of their consultation paper on CSD settlement fails reporting) *but are yet subject to a formal approval.*
 - For intra-CSD (CSD-internal) settlement, the actual CSDR penalties application depends on whether the CSD is subject to CSDR or equivalent legislation.

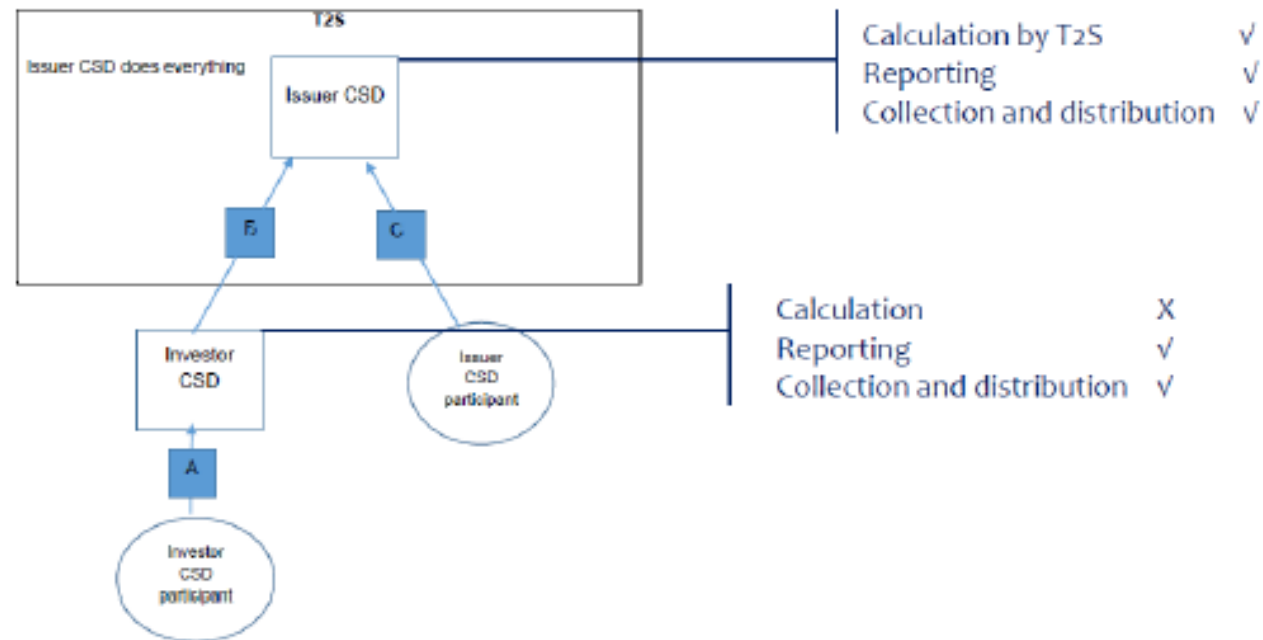
9. Cross-CSD Settlement Fails

- Settlement scenario sample 1A: T2S

9.2 SCENARIO 1A

ASSESSMENT OF SCENARIO FOR PENALTIES CALCULATION, REPORTING AND COLLECTION OBLIGATION

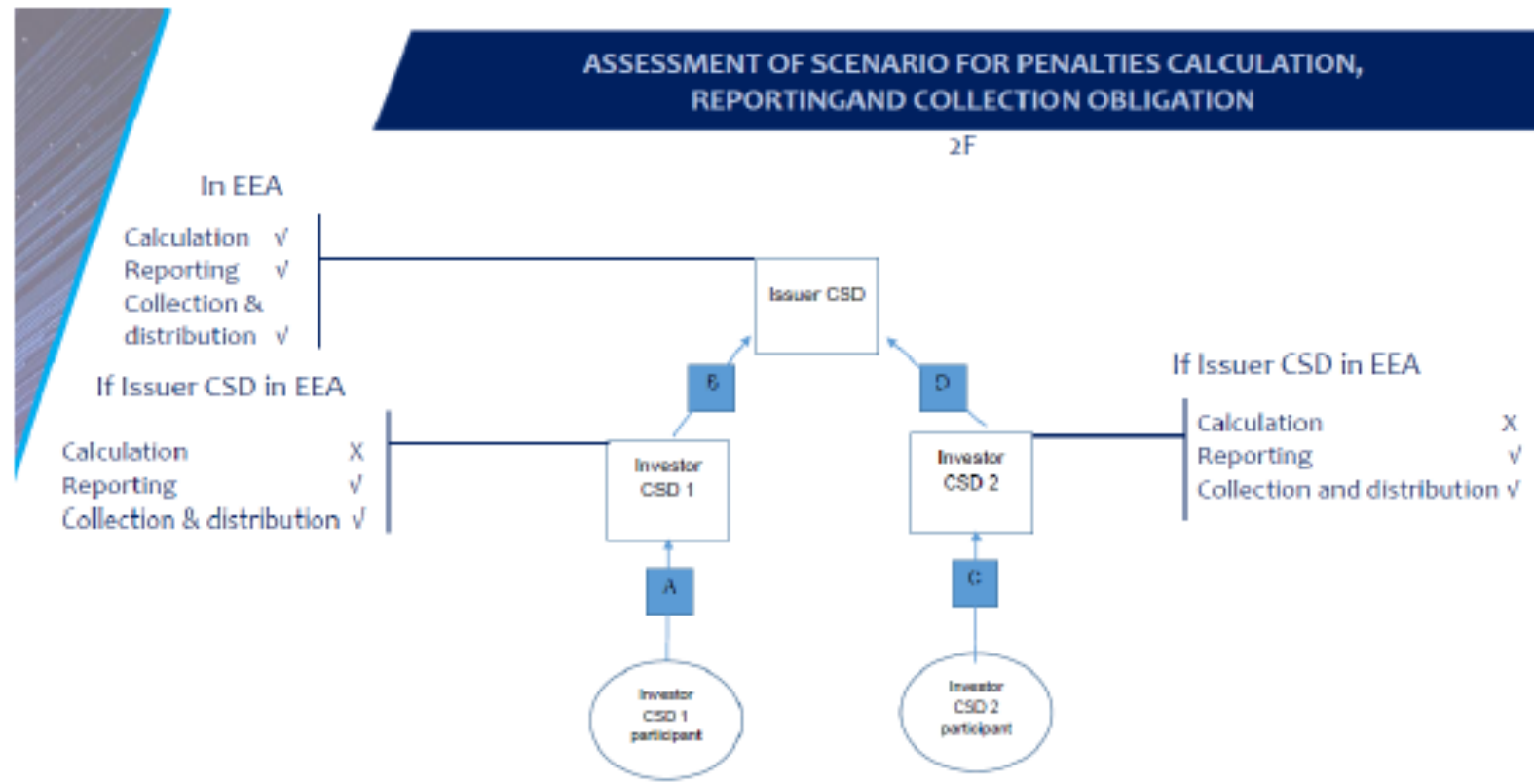
1A



9. Cross-CSD Settlement Fails

- Settlement scenario sample 2F: non-T2S (EU/ EEA Issuer-CSD)

9.10 SCENARIO 2F



9. Cross-CSD Settlement Fails

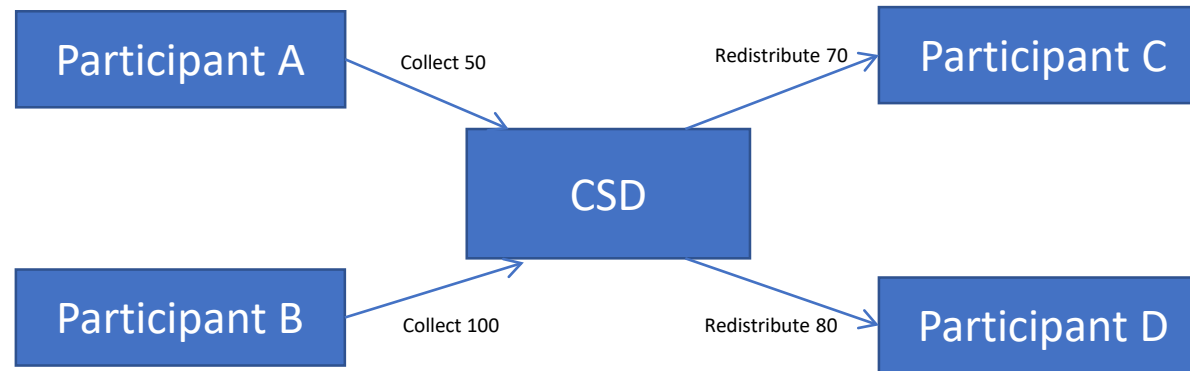
- **Reconciliation aspects**
- Cross-CSD reconciliation will be needed at least in the following situations:
 1. CSD participant insolvency (ESMA guidelines pending); inability of CSDs to (fully) collect penalties due
 2. Suspension of settlement of an ISIN; no penalties shall be applied (or buy-in initiated) once a CSD has suspended settlement of an ISIN, e.g. due to an “undue creation/ deletion of securities” situation.
- **Note:**
 - CSDs must not distribute penalties that they have not actually collected.
 - ESMA Q&As updated 30.01.19 re. non-application of penalties extend #2 to suspension of trading; issue: CSDs do not receive suspension information from TVs (which TVs are actually to be considered for a single (multi-listed) ISIN ?)

10. Collection & Redistribution of Penalties (Payment)

- CSDs act as non-risk-taking counterparty to all payments
- Phased collection and redistribution process
 - Collection from participants which are not investor-CSDs
 - Redistribution from investor-CSDs to calculating-CSD
 - Redistribution from calculating-CSD to participants (incl. investor-CSDs)
 - Redistribution from investor-CSDs to participants
- Prioritize Cross-CSD payments
- Two categories of participants: full members, Investor-CSDs

10. Collection & Redistribution of Penalties (Payment)

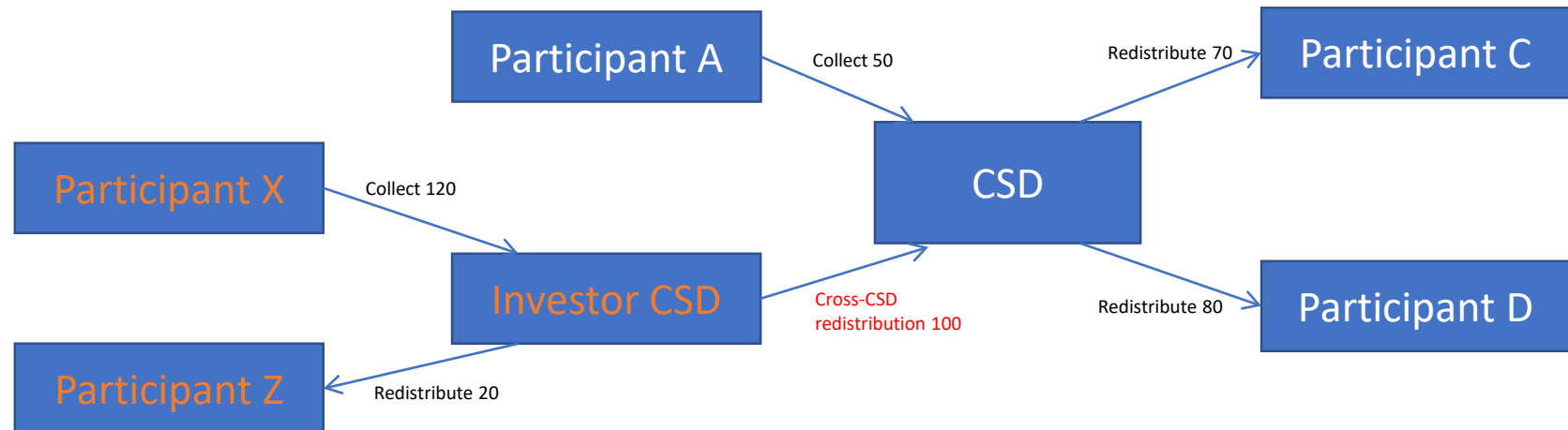
- Example Scenario ‘Single CSD’:



- Two phases:
 1. Collection from participants
 2. Redistribution to participants

10. Collection & Redistribution of Penalties (Payment)

- Example Scenario 'Cross-CSD CSD', variant A:

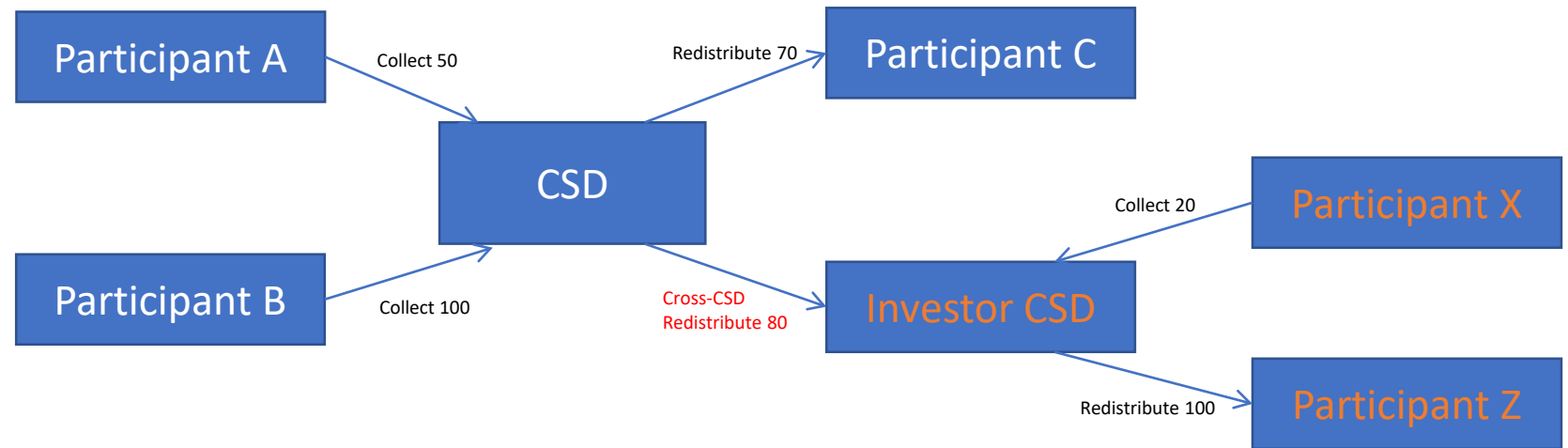


- Three phases:

1. Collection from participants (which are not investor-CSDs)
2. Redistribution from investor-CSD to calculating CSD
3. Redistribution from calculating CSD to participants

10. Collection & Redistribution of Penalties (Payment)

- Example Scenario 'Cross-CSD CSD', variant B:

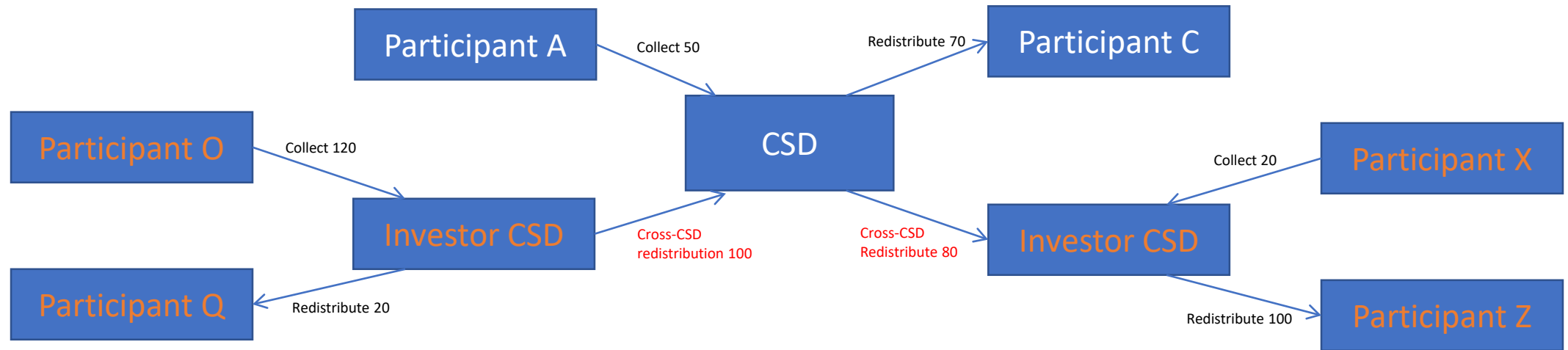


- Three phases:

1. Collection from participants
2. Redistribution from calculating CSD to participants (incl. investor investor-CSD)
3. Redistribution from investor CSD to participants

10. Collection & Redistribution of Penalties (Payment)

■ Example Scenario 'Cross-CSD CSD', variant C:



■ Four phases:

1. Collection from participants (which are not investor-CSDs)
2. Redistribution from investor-CSDs to calculating CSD
3. Redistribution from calculating CSD to participants (incl. investor investor-CSD)
4. Redistribution from investor CSD to participants

11. Messaging

- Reporting- ISO20022 standard
 - A semt.xxx message is in development dedicated solely to penalties reporting. To be released in NOV20.
 - To report Daily initial/Daily modified/Monthly aggregated reports, whereby level of detail changes according to report type
- Reporting- ISO15022 standard
 - SWIFT Change requests to enhance MT537 and MT548 for penalties reporting are in development. To be released in NOV19.
- Reporting- Standards usage
 - Due to alignment ISO20022 messages will be convertible into ISO15022 and vice-versa allowing to cover wide range of reporting needs
 - Usage of a reporting standard to be decided within the specific CSD<->participants landscape
- Reporting- Proprietary
 - For CSDs possible to provide reports besides XML (.csv, .xls, .xlsx) formats if the content's compliance with ISO15022/20022 is maintained

11. Messaging

- Reporting- other
 - ISIN prices will not be informed
 - SME aspect to be informed at instruction level
 - Penalties positions will not inform about payments itself- i.e. they will inform about incurred penalties also in respect to CCP, insolvency and other ad-hoc processes
- Payments- Payment pre-advices
 - Besides the semt.xxx and enhanced MT537 and MT548 messages aimed primarily at the reporting process, payment pre-advices messaging will be available to cover areas of the payments process
 - To inform on the 15th business day specifically about payments to happen on the 17th business day
- Payments- other
 - It is not foreseen to inform about the successful completion of the Collection & Redistribution process

12. Miscellaneous

- CCP transactions
 - For failing matched settlement transactions involving a CSD-participant that is a CCP, the CSD shall ensure that CCPs are provided with the calculation but not actually charge or distribute the penalties to the CCP.
 - Hence, CSDs shall exclude from their collection and distribution processes the amounts due to be paid and entitled to be received by a CCP that is a CSD participant and exclude the CCP activity from its
 - reporting of the amount to be paid and to be received; and
 - actual credit or debit payments execution
- CCPs are obliged to collect from/ distribute to their clearing members the penalties and report to the CSD that the collection/ redistribution of the penalties as calculated and reported by the CSD has been done
- Note:
 - CCP-to-CSD reporting process not yet defined, discussion with EACH to be initiated



Open points:

- Payment process - what to do in case of no or only partial payment by a participant ?
- Suspension of settlement – how will T2S act (penalties calculated, to be removed by CSDs ?) ?
- ESMA Q&As 30.01.19 re. non-application of penalties – is extension to suspension of trading reasonable ?



Questions from the
audience ?

Next steps

- Follow-up on open points
- ECSDA Framework update
- Dedicated customer information sessions may be organized by single CSDs

