



Central Securities Depositories Regulation

Settlement Discipline Regime

November 2022

Information Classification: Public

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1. Overview

The Central Securities Depositories Regulation (CSDR) rules on the Settlement Discipline Regime (SDR) introduce a number of measures to prevent settlement fails by ensuring that all transaction details which are required to effect settlement are provided well in advance of the intended settlement date (ISD), as well as further incentivising timely settlement through cash penalty fines and buy-ins.

Important Note: In November 2021, it was confirmed that the introduction of the mandatory buy-in requirements has been delayed and a postponement of 2-3 years is envisaged. We have therefore removed the mandatory buy-in requirements from this document. Please see page 14 for further details.

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

One component of the regime is the introduction of cash penalties to be applied to all failing matched transactions.

The implementation for the SDR came into force on 1 February 2022.

1. General

a) What are the specifics of the SDR?

The SDR introduces two main sets of measures:

- measures to prevent settlement fails by improving matching and settlement rates; and
- measures to address settlement fails: cash penalties and mandatory buy-ins

MONITOR 	PREVENT 	ADDRESS 
<ul style="list-style-type: none"> • Transparent settlement efficiency rates • Top 10 lowest reported by CSD monthly 	<ul style="list-style-type: none"> • Trade confirmations and allocations • Additional fields • Tolerance levels • Partial 	<ul style="list-style-type: none"> • Cash penalties • Mandatory buy-ins (MBIs postponed)

The latter set of SDR measures introduces a cash penalty process for settlements that do not occur on time and mandatory buy-ins for trades that fail to settle after a certain period of time (e.g., ISD+4).

The settlement discipline measures include the following elements:

- Late matching fines
- Late settlement fines
- Mandatory buy-ins (currently postponed)

Late matching and late settlement fines are generally referred to as settlement fines or cash penalties.

(b) What is the intention of the new settlement discipline?

The new discipline regime intends to improve settlement efficiency in the market. The onus will be on firms to input, match, and settle transactions in good time, or be subject to cash penalties as a result of failure to do so.

2. Settlement Fails

(a) What is a settlement fail?

A settlement fail refers to a trade that has not settled on the intended settlement date.

A settlement fail includes total, as well as partial failure, to settle on the intended settlement date due to a lack (in whole or in part) of securities or cash for the settlement to take place.

A settlement fail is deemed to occur irrespective of the underlying cause. The CSDR measures apply regardless of any other default procedure that may be applicable in respect of the underlying transaction and do not depend on the outcome of any dispute associated with the trade.

(b) What instruments are in-scope?

Transferable securities i.e., equities, bonds, depository receipts, exchange traded funds (ETFs), money market instruments, UCITS (excluding issue and redemption of units) and emission allowances eligible for settlement on the CSD which are:

- Admitted for trading or traded on an EU trading venue; or
- Cleared (or eligible for clearing) by an EU central counterparty (CCP).

(c) Does this affect non-UK or European domiciled securities settling in Euroclear?

It is the place of settlement which indicates if a trade is in scope. Any settlement at Euroclear Bank is deemed in scope for the settlement discipline regime.

Please note – ESMA guidance is that it depends if the ISIN is eligible on a European trading venue or cleared by an EU CCP.

(d) Are cross border settlements – from EU to EU – part of the penalty regime?

It is the place of settlement which indicates if a trade is in scope. Any settlement in the CSDR markets is deemed in scope for the settlement discipline regime. European funds are in scope for penalties.

Please note – ESMA guidance is that it depends if the ISIN is eligible on a European trading venue or cleared by an EU CCP.

(e) Are stock borrows in-scope for settlement fails?

Stock loans and returns will be in scope for penalties if not settled on the intended settlement date.

2. Prevent Settlement Failure

The timely booking and matching of trades pre settlement (i.e., before ISD) becomes of the utmost importance.

1. Trade Confirmations and Allocations

CSDR introduces measures to prevent fails, which focus on the trade confirmations and allocation process, to encourage automated settlement based on the availability in advance of all necessary information.

(a) What does the regulation require?

The regulation sets out detailed rules relating to the message flows between the two parties to a trade:

1. **The investment firm** (defined widely); and
2. **Its client**, once an investment firm has executed a trade on behalf of its client.

The regulation requires that the investment firm include these rules in the contractual arrangements with its client.

Once the investment firm has sent the confirmation of the execution to a professional client, the client is obliged to confirm its acceptance of the terms of the transaction. The client is also obliged to send to the investment firm a set of specific details relating to the allocations of securities or of cash. The client is obliged to send both these messages by a specific deadline (see below in section (b) for details). The client can combine both messages in a single message.

Investment firms must confirm receipt of the confirmation and allocation messages within two hours of receipt.

Investment firms are under the obligation to offer their professional clients the option of sending the confirmation and allocation messages electronically using international communication standards.

Please note that the term “professional client” is not defined and does not necessarily track the definition used under MiFID. It appears that the term is used to describe anyone that is not a retail client so the rules would also apply to a trade with an entity that is classified under MiFID as “eligible counterparty”. For retail clients, the exchange of this information is still required but the timeline is extended to the following business day.

(b) What is the impact to market participants?

Professional clients will need to ensure that they provide the investment firm with the confirmation message, and with all required information in an allocation message **within specified timeframes**. Clients should expect their “investment firm” would request such information and put in place the arrangements to be able to provide it and in turn have their clients provide it to them within the specified timeframes.

- The investment firm should receive the confirmation and allocation messages by close of business on the business day that the transaction took place.
- If the two parties are in time zones with more than a 2-hour difference, or if the order has been executed after 16:00 CET, then there is an extension of the deadline until 12:00 CET on the following business day.

Any contractual agreements between a professional client and an investment firm must include the communication requirements of the confirmation and allocation messages, the information to be provided, what method of communication will be used, and the timeframes by which messages should be sent.

The [ESMA guidance](#) (issued by way of [FAQs](#)) provides firms with a more flexible approach in achieving compliance with the rules. Firms should also review the exemptions from the requirements to exchange the information as set out within the rules to confirm whether any of those exemptions is available to them where they act as an “investment firm” under the rules. Firms may wish to liaise with their industry associations as they work towards agreeing market practice in several important areas of the SDR that are not covered or addressed in sufficient detail by CSDR itself.

2. Additional Settlement Instruction Fields

(a) What does the regulation require?

CSDs require their participants to populate additional fields in their settlement instructions.

The additional fields are:

- **Transaction type**: The transaction type will become mandatory on settlement instructions to CSDs
- **Place of Trade and Place of Clearing**: In some instances, CSDs will also require participants to instruct the place of trade and the place of clearing

The place of trade will be used to derive the correct cash penalty rate for the relevant financial instrument for Small Medium Enterprise (SME) growth markets. If clients do not notify this, then they may receive a higher cash penalty, as CSDs will default the transactions as not having been executed on a trading venue.

Note: In order for a CSD to apply the reduced SME Growth Market penalty rate, both participants need to have entered the same SME Growth Market in the Place of Trade field.

The latest European Central Securities Depositories Association (ECSDA) Penalty Framework states:

“For the sake of identifying the applicable penalty rate, CSDs need to identify whether the instrument to be settled was actually traded on an EU SME Growth Market by verifying both, the receiving and delivering instruction of the settlement transaction.

Only when both instructions show the same “Place of trading” four-digit MIC (Market Identifier Code) the reduced penalty rate applicable to SME instruments shall be applied.”

You can find the list of SME Growth Markets [here](#).

The place of clearing is used to identify if the transaction was cleared through a central counterparty (CCP). Depending on the outcome of current discussions with ESMA, this may be used to identify who is responsible for managing the collection and distribution of cash penalties (the CSD or the CCP).

(b) What is the impact to firms?

Firms will need to ensure that they instruct all relevant details necessary as this could affect whether their transactions settle on time or become subject to a cash penalty.

3. Tolerance Matching

(a) What does the regulation require?

The settlement discipline regime of CSDR contains various measures to prevent settlement failure. CSDs 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:

- €2 for up to €100,000
- €25 for over €100,000

For settlement instructions in other currencies, the tolerance level per settlement instruction shall be of equivalent amounts based on the official exchange rate of the ECB, where available.

4. Partial Settlement

(a) What does the regulation require?

CSDs are required to provide participants with functionality to partially settle transactions. Early partial settlement, between intended settlement date (ISD) and buy-in deadline date -1, can reduce the penalty fines payable by the delivering party.

On the deadline date of the buy-in extension period (e.g., ISD +4 for liquid securities), the regulation states that any available stock must be used to partially settle, unless the settlement instruction is on hold.

(b) How do auto-partials work?

Auto-partials can be instructed at transaction level. If a firm chooses to move to a segregated account, you have the option to allow auto-partials (PART). We believe that by moving to auto-partial settlement, firms will increase settlement efficiency and reduce settlement fines. Please note that auto-partial settlements are only available at segregated account level.

The CSD will split the instruction based on the stock position available and the cash consideration will be calculated by as per the new quantity of shares.

Example 1 Counterpart A sells 1,000 XYZ shares for €1,000 to Counterparty B	
Both A & B have the account set to PART	
ISD	Counterparty A has a position of 500 shares
ISD	Counterpart A delivers 500 XYZ Shares vs €500 to Counterparty B
ISD + 1	Counterparty A has received and has a further position of 500 shares
ISD + 1	Counterpart A delivers the final 500 XYZ Shares vs €500 to Counterparty B

If the counterparty uses NPAR then partials will not occur.

Example 2	<ul style="list-style-type: none"> • Counterpart A sells 1,000 XYZ shares for €1,000 to Counterparty B • Counterparty B Sells 1,000 XYZ Shares to Counterparty C for €1,100
<p>Both A & B have the account set to PART</p> <p>Counterparty C has the account set to NPAR</p>	
ISD	Counterparty A has a position of 500 shares
ISD	Counterpart A delivers 500 XYZ Shares vs €500 to Counterparty B
ISD	Counterpart B cannot deliver to Counterparty C
ISD	<p>Counterparty B has a long stock balance of 500 Shares</p> <p>Counterparty B will be long of stock and short of cash for one day. Therefore, there will be a financing cost charged by the CSD/custodian if the account is overdrawn.</p>
ISD+1	Counterparty A delivers 500 XYZ shares to Counterparty B vs €500
ISD+1	Counterpart B delivers 1,000 XYZ shares to Counterparty C vs €1,100

3. Address Settlement Failure

1. Cash Penalties

(a) What are the specifics of cash penalties?

The objective of cash penalties is to create a standardised and harmonised regime across the EU to be applied in the event of settlement fails. 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.

(b) 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.

(c) Which type of instructions are not subject to cash penalties?

- Redemptions (i.e., REDM)
- Corporate actions on stock (i.e., CORP)
- Technical instructions (e.g., T2S automatic realignments)

(d) What are the types of cash penalties?

There are two types of fines:

- **Late Matching Fail Penalty (LMFP):** penalty that applies due to the matching taking place after the ISD. LMFPs will be charged to the participant who was last to enter or modify the settlement instruction.
- **Settlement Fail Penalty (SEFP):** penalty that applies due to the non-settlement of a matched transaction on or after its ISD. SEFPs will be charged to the participant who is responsible for the fail – this can be due to an ‘on hold’ instruction, linked instructions on T2S, ‘lack of securities’ or ‘lack of cash’. The CSD will conduct the checks to determine fault in that order.

Both, a LMFP and a SEFP, can apply on a single instruction; they may be charged to the delivering, receiving or both participants, depending on which of the two participants caused a) the late matching and b) the settlement fail.

However, LMFP and SEFP cannot both apply for the same business day: either LMFP or SEFP can occur, depending on the matching timestamp (being before or after the CSD’s settlement cut-off time).

Example 1 Late Matching Penalty

1.1 Counterparty A sells to counterparty B

1.2 Counterparty B instructs on ISD – 1

1.3 Counterparty A instructs on ISD + 1

1.4 Trade matched and settles ISD+1

Outcome Counterparty A receives a one day matching fine

Example 2 Late Matching Penalty

2.1 Counterparty A sells to counterparty B

2.2 Counterparty B instructs on ISD – 1

2.3 Counterparty A instructs on ISD + 1

2.4 Trade matched but Counterparty A is short of stock to deliver

2.5 Trade settles on ISD+2

**Outcome Counterparty A receives a one day matching fine
Counterparty A receives a one-day late settlement fine**

(e) What instruments are in-scope for cash penalties?

Broadly speaking, the instruments in scope for cash penalties are transferable securities i.e., equities, bonds, depository receipts, exchange traded funds (ETFs), money market instruments, sovereign debt, UCITS (excluding issue and redemption of units) and emission allowances eligible for settlement on the CSD, which are:

- Admitted for trading or traded on an EU trading venue; or
- Cleared (or eligible for clearing) by an EU central counterparty (CCP).

The complete list is set out in the legislation and cross refers back to MiFID II as to the definition of 'transferable securities'.

(f) How do cash penalties work?

Fines will be non-profit making for the CSD (although CSDs are charging fees for administering the system) as all credits and debits will be passed, on a trade-by-trade basis, to the clearing participants at the end of the month on a net basis i.e.

- Debits: Will be passed onto the failing settlement participant
- Credits: Will be passed onto the settlement participant affected

The CSD will apply a net debit or credit to the settlement participant on a monthly basis, along with a gross file to enable reconciliation:

Debits

- Late instructions
- Late matching
- Short positions

Credits

- Counterparty late instructions
- Counterparty late matching
- Counterparty short positions

(g) What are the cash penalty rates?

Type of Fail	Type of Security	Rate
Lack of securities	Liquid shares	1.0 bps
	Illiquid shares and other financial instruments (such as ETF, certificates, DR etc.)	0.5 bps
	SME growth market and other financial instruments	0.25 bps
	Corporate bonds	0.20 bps
	SME growth market bonds	0.15 bps
	Government and municipal bonds	0.10 bps
Lack of cash	Discount rate per currency with a floor of 0	

(h) How will cash penalties be calculated?

- Cash penalties are debited against CSD participants who cause settlement fails either for late matching or fail settlement and credited to the affected party.
- Against payment, and free of payment, settlement instructions are subject to cash penalties.
- Cash penalties are calculated daily and per day as from the ISD until the actual settlement or cancellation date of the instruction:
- **For Settlement Fail Penalty:** 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
- **For Late Matching Fail Penalty:** penalties apply retroactively from the ISD until the actual matching date.
- CSDs collect and distribute penalties to affected participants, unless one of the participants is a CCP, in which case CSDs must ensure that CCPs collect and distribute penalties to and from clearing members.

Example (for illustration purposes only)

- Internal delivery of 100,000 Siemens (SIE.DE) ordinary shares against payment of EUR 10,000,000.
- Settlement status: A settlement instruction is matched but fails due to lack of securities for three business days after the intended settlement date.
- The applicable daily penalty rate would in this example be **1.0 basis point**.

Let us suppose that the reference price (in this example being the closing price of the shares on the most relevant market in terms of liquidity) to be applied for penalty calculation is as follows:

- Day 1: EUR 100
- Day 2: EUR 115
- Day3: EUR 90

The penalty would therefore be calculated as follows:

- Penalty day 1: 100,000 shares x 0.01% (or 0.0001) x 100 EUR = 1, 000 EUR
- Penalty day 2: 100,000 shares x 0.01% (or 0.0001) x 115 EUR = 1,150 EUR
- Penalty day 3: 100,000 shares x 0.01% (or 0.0001) x 90 EUR = 900 EUR

Total penalty amount = 3,050 EUR

The total penalty amount would have to be paid by the customer that is failing to deliver the securities, to the customer suffering from the failure to receive securities.

Penalties are calculated as a percentage of the market value of the security, with different rates applied as follows:

REASON FOR FAILURE	TYPE OF SECURITY	LIQUIDITY INDICATORS	SME GROWTH MARKET	PENALTY RATE (IN BPS)
Lack of Security	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
Lack of Cash	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

(i) Will penalties continue to apply indefinitely?

Yes. Cash penalties are applicable until the point at which the settlement instruction is settled or cancelled. The mandatory buy-in requirement provided a definitive end-date by when the settlement instruction must be settled or cancelled. As the mandatory buy-in requirement is has been disapplied, this means that cash penalties will continue to be accrued indefinitely.

(j) What currency are penalties collected and redistributed in?

AFME members' expectation is that the default should be that penalties are credited and debited in the currency of the settlement instruction (or the currency of the instrument in cases of FOP instructions).

(k) Will CSD participants pass back penalties to their clients?

The spirit of the regulation is to incentivise timely settlement by penalising the party at fault for the failure of the transaction. AFME's expectation, therefore, is that, generally, participants such as custodians and settlement agents will pass back penalties through the chain to the trading parties.

Where the custodian or settlement agent is responsible for the settlement fail, AFME recommends that the penalty is not passed back.

2. Mandatory Buy-Ins Postponed

In late November 2021, we welcomed the positive news that the Mandatory Buy-in (MBI) requirements of CSDR will be delayed and no longer apply on 1 February 2022.

ESMA will look to provide forbearance until the formal legislative process is complete to authorise the delay of the MBIs and then put in place the necessary amendment to Level 2 legislation to effect a delay in implementation. We understand that a postponement of some 2-3 years for the introduction of the MBIs is envisaged.

We have therefore removed the requirements on MBIs from this FAQ document.

What does this mean for firms?

Firms will no longer be subject to the MBI requirements. This means there is now no need to appoint a buy-in agent and instruct a buy-in when a trade has failed to settle (e.g., on intended settlement date +4 for liquid securities) in the immediate future.

It is important to note that the **cash penalty requirements of SDR still apply as of 1 February 2022.**

Useful Links

- [Central Securities Depository Regulation](#)
- [CSDR RTS on Settlement Discipline](#)
- [CSDR Delegated Act on Cash Penalties](#)
- [ESMA Q&A on CSDR](#)
- [ECSDA Penalties Framework](#)
- [AFME Guidelines for Bilateral Penalties Claims](#)
- [ESMA CSD Register](#)
- [FIRDS Database](#)

For more information, please contact us:

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