

ABBL Conference

Central Securities Depositories Regulation

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Impact on CSD and ICSD participants

11 January 2018

Agenda

- Welcome by the ABBL and Clearstream
- CSDR and its impact on market participants
- Final remarks by LuxCSD
- Q&A Session
- Networking Cocktail

Welcome by

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Central Securities Depositories Regulation

Relevance for Participants of Clearstream Banking SA (CBL), Clearstream Banking AG (CBF) and LuxCSD SA.

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- 1 CSDR Impacts on Participants
- 2 Requirements still under Discussion

Credit & Collateral

Credit & Collateral

1. Collateralisation of credit exposures

Clearstream must ensure that all credit extensions are covered by sufficient collateral and will therefore adapt its income payment policy as well as its syndicated new issues payment procedures to ensure compliance with the collateralisation obligation. In addition, Clearstream is required to maintain sufficient Qualifying Liquid Resources (QLR) for currencies where credit is allowed*.

Impact on participants: discontinuation of unsecured lines; collateralisation of credit limits required for use of income proceeds until funds are received by Clearstream; collateralisation of payments to common depository in syndicated new issues as from submission of irrevocable commitment to pay; availability of credit may vary per currency*.

2. Collateral eligibility & valuation

Clearstream must adapt its collateral eligibility & valuation approach to meet enhanced requirements aimed at further reducing credit risk exposures for CSDs. Measures will require adjustments to collateral hierarchy (classification into 3 tiers), concentration limits, price age, and collateral haircuts.

Impact on participants: adaptations (e.g. increase, substitution, diversification) to collateral portfolios maintained with Clearstream.

Further details on individual client impacts will be communicated bilaterally at a later stage of the CSDR authorisation process.

* Liquidity requirements still under regulatory review and impact analysis

Integrity of the Issue (1/3)

Daily Reconciliation

- **Daily Reconciliation**

In order to strengthen the monitoring of the integrity of the issue, CSDR Article 37 requires participants to reconcile their bookkeeping of holdings with the CSD on a daily basis.

In order to perform this daily reconciliation, customers must retrieve the reconciliation file on a daily basis by using the information channels Clearstream provides already today. If the customer identifies a reconciliation break*, he is obliged to revert to Clearstream without undue delay. Participants must provide Clearstream with the information that Clearstream deems necessary to ensure the integrity of the securities issue.

- **Impact on Participants**

Participants need to change their download-cycle of the necessary report to “daily” and need to set up appropriate processes for the conduct of daily reconciliation [internally] as well as put in place arrangements to communicate effectively with Clearstream to solve reconciliation breaks as and when they occur.

* Mismatch between the information provided by the CSD and the records in the books of the customer

Integrity of the Issue (2/3)

Suspension of Settlement

- **Suspension of Settlement**

Clearstream is obliged to perform a daily reconciliation of the securities positions it records in its systems against the accounts of external counterparties. If the reconciliation identifies an undue creation or deletion of securities, settlement in this ISIN must be suspended until the reconciliation break has been resolved.

The suspension and resumption of settlement in a specific ISIN will be communicated to the participants via existing communication channels, such as a customer announcement on operational information via Clearstream's website.

- **Impact on Participants**

Participants need to put in place appropriate processes to monitor Clearstream publications and alerts regarding the suspension of settlement for a given ISIN(s).

Integrity of the Issue (3/3)

Corporate actions for ISINs with an undue creation or deletion

- **Processing of corporate actions**

Under CSDR, Clearstream is obliged to reconcile the positions recorded in its books before determining the entitlements to the proceeds of a corporate action. In case a reconciliation break is identified, the processing of the corporate action will be delayed until the reconciliation break has been resolved.

In the event of a corporate action in a security for which Clearstream is the investor CSD*, Clearstream will not process any settlement instructions in a securities issue or reflect the result of the corporate action in its books until a confirmation of processing of the corporate action has been received from the Issuer CSD**.

If the proceeds of the corporate action have been paid out in advance under a credit agreement, such delays will be considered a custody advance and influence duration and height of credit consumption.

- **Impact on Participants**

Participants need to prepare their liquidity planning to unforeseen delays in the processing of corporate actions. Furthermore, credit lines with Clearstream need to be adjusted accordingly to provide sufficient limits for such unforeseen events. If not already the case, customers should ensure that relevant staff are set-up to receive Clearstream announcements on suspensions for (a) given ISIN(s).

* Investor CSD is a CSD that is either a direct or indirect (via an intermediary) participant in the securities settlement system operated by another CSD

** Issuer CSD is a CSD that either performs initial recording of securities in a book-entry system (notary service) or maintains securities accounts at the top tier level (central maintenance service)

LEI for Issuers

Issuance

- **Provision of valid LEI**

Issuers must provide the CSD with a valid LEI.* According to Article 55.2 of the RTS (EU 2017/392), if no valid LEI is available, CSDs are obliged to refuse to provide their services to the issuer.

- **Impact on Issuers**

Issuers need to put in place arrangements to apply for an LEI at their responsible LEI Local Operating Unit. Furthermore, it needs to be ensured that the LEI is kept valid according to the GLEIF** principles.

* LEI: Legal Entity Identifier, see ISO 17442

** GLEIF: Global Legal Entity Oversight Committee

Risk Management

Key Participants

- **Identification of Key Participants**

Article 67.1 of EU 2017/392* requires CSDs to identify 'Key Participants'. The classification as a Key Participants is dependent on transaction volumes and transaction values, on a material dependencies analysis and on the potential impact on other participants. CSDs have to ensure through an additional risk assessment that key participants have put in place minimal measures to have a robust operational setup. This assessment by the CSD will be done by a questionnaire where participants are asked to provide information regarding their operational setup (e.g. Operational risk, Business Continuity, Disaster recovery and IT security).

Participants who will be designated as "key" will be approached by Clearstream during Q1 2018.

- **Implication for Key Participants**

If deficiencies are detected, the key participants are asked to put in place measures to remedy these deficiencies and to provide the CSD with an action plan to reduce the overall risk profile of the key participant to an acceptable level. Upon request, the CSD will provide information on any such risk identified to competent and relevant authorities. Key Participants have to demonstrate to the CSD at least yearly that their processes are robust enough to continuously meet operational requirements.

* EU 2017/392: Regulatory Technical Standards (RTS) on authorisation, supervisory and operational requirements for central securities depositories

Account Segregation

Segregated Accounts at the CSD

To enhance the protection of the assets of their participants and those of their clients, CSDs are required* to offer their participants a choice of account type that enables any participant to segregate securities at the level of the (I)CSD itself only. The costs for this segregation are to be borne by the participants' clients requesting such segregation. Accounts may take one of the following forms:

- **Omnibus accounts**

A common form of holding assets that enables any participant to hold in one securities account the securities that belong to different clients of that participant. This account is then represented in the participants books and individual holdings of the participant's customers holding are kept in multiple accounts at the level of the participant

- **Segregated accounts**

CSDs will offer "segregated" securities accounts for a participant's customers in order to enable a participant to:

- segregate the securities of the participant from those of the participant's client
- segregate the securities of any of the participant's clients

Segregated accounts can be opened at the CSD upon the participant's request and in accordance with defined procedures, including compliance and relevant approvals.

- **Implication for Participants**

Existing Clearstream account structures – and associated description of costs - meet the requirements laid out in CSDR. If segregated accounts are established at the CSD, these will have to be included within the daily reconciliation. The statements which will be sent out for reconciliation provide the information in which of the participant (sub-) account the securities are kept.

* See EU 909/2014 (Central Securities Depositories Regulation) Article 38 ("Protection of securities of participants and those of their clients")

Settlement Internalisers

Reporting requirements

▪ Definition of a Settlement Internaliser

A Settlement Internaliser is a credit institution which executes transfer orders on behalf of clients or on its own account other than through a securities settlement system.

▪ Impact on Settlement Internalisers

According to CSDR Article 9, Settlement Internalisers are required to report on a quarterly basis to their National Competent Authority, the aggregated volume and value of the transactions they have settled outside securities settlement systems.

This reporting

- Has to be done in the format provided by ESMA in the Technical Standards* for internalised settlement
- Must make use of ISO-standards.

The period that the first report should cover runs from 1 April 2019 until 30 June 2019; as a consequence, settlement internalisers are expected to send the first report to the competent authorities by 12 July 2019.

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Settlement Discipline Regime

Penalties Regime and Buy-Ins

- **Penalties Regime**

Currently, Clearstream does not charge a late settlement fee for their participant's who deliver their securities not on the ISD*; CSDR Article 7.2 requires CSDs to charge penalties on late securities deliveries.

Clearstream thus has to put in place a penalty mechanism for settlement fails, including cash penalties calculated on a daily basis and applied to all financial instruments admitted to traded on a trading venue or CCP-cleared. Further, the penalties calculation shall take into the account asset type, liquidity and type of transaction.

Hence, if a settlement fails due to one party's inability to deliver the securities, the party who has failed to deliver the securities on ISD will be fined. The fine will then be distributed to the other party to compensate for the settlement fail.

- **Mandatory Buy-Ins**

CSDR Article 7.3 obliges to initiate a mandatory buy-in for settlements in any financial instrument that cannot be settled within four business days after the ISD, seven days for illiquid securities or 15 days for transactions on SME markets.

The buy-in aims at obtaining the failed-to-deliver securities from the open market and to deliver them to the receiving party and thus to settle the transaction within a short time frame.

The monetary equivalent i.e. the cost of this buy-in will be debited to the failing party.

CSDs or trading venues will not initiate nor execute buy-ins themselves but are expected to monitor and provide relevant information to the trading counterparties. Counterparties will arrange the buy-in themselves in line with prescribed rules and reporting requirements.

- **Status of the regulatory process**

Level 2 Technical Standards are expected to be adopted by the European Commission during the course of Q1 2018 at the earliest.

* ISD: Intended Settlement Date

Annex A: Collateral Tier Criteria

Annex B: Collateral Haircuts Determination

Collateral Tier criteria (1/2)

Tier	Article	Criteria	Attribute
1a	10 (1)	Instrument type	Debt instrument or cash
	10 (1) (a) (i-iv)	Issuer type	Defined issuer or guarantor*
	10 (1) (b)	Credit risk	A- and above
		Market & Liquidity Risk	Low (Score to be defined)
	10 (1) (c)	Currency	All**
	10 (1) (d)	Enforceability	Freely transferable
	10 (1) (e) (i-ii)	ECB-eligibility OR	ECB-eligible
		Repo market OR	Active repo market
		Funding arrangement	prearranged and highly reliable funding arrangement
	10 (1) (f)	Price data	Published daily
10 (1) (g)	Convertibility	Same-day	

Tier	Article	Criteria	Attribute
1b***	10 (2)	Instrument type	Transf. securities or money market instr. (incl. equities)
	10 (2) (a)	Credit risk	BBB- and above
	10 (2) (b)	Market & Liquidity Risk	Low (Score to be defined)
	10 (2) (c)	Currency	All**
	10 (2) (d)	Enforceability	Freely transferable
	10 (2) (e) (i-ii)	ECB-eligibility OR	ECB-eligible
		Repo market OR	Active repo market
		Funding arrangement	prearranged and highly reliable funding arrangements.
	10 (2) (f)	Convertibility	Same-day cash convertibility
	10 (2) (g)	Price data	Avail. daily/close to real-time
	10 (2) (h)	Issuer	No own issues/close links; no CSP
10 (2) (i)	Wrong-way risk	Not subject to significant WWR	

* Governments, Central Banks, Multilateral Development Bank (in accordance with Art. 117 of Reg. (EU) No 575/2013)

** Clearstream is able to manage all currencies available in its internal systems.

*** Not included in 1a

Collateral Tier criteria (2/2)

Tier	Article	Criteria	Attribute
2	11 (1)	Instrument type	Financial instruments
	11 (1) (a)	Enforceability	Freely transferable
	11 (1) (b)	ECB-eligibility	ECB-eligible
	11 (1) (c)	Currency	All*
	11 (1) (d)	Funding arrangement	prearranged and highly reliable funding arrangement
3	11 (2)	Instrument type	Financial instruments
	11 (2) (a)	Enforceability	Freely transferable
	11 (2) (b)	Currency	All*
	11 (2) (c)	QLR and	Sufficient level of QLR
		Funding arrangement	Prearranged funding arrangement

* Clearstream is able to manage all currencies available in its internal systems.

Collateral Haircuts

Collateral Haircuts will be determined based on the following factors:

- Type of Asset
- Level of credit risk associated with the instrument
- Country of issuance of the asset
- Maturity of the asset
- Historical and hypothetical future price volatility of the asset in stressed market conditions
- Liquidity of the underlying market, including bid-ask spreads
- Foreign exchange risk (where applicable)
- Wrong-way risk (where applicable)

