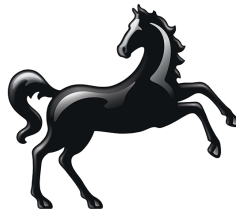


Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH
Frequently Asked Questions about Central
Securities Depositories Regulation (CSDR)
Settlement Discipline Regime



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This is to help you understand the CSDR Settlement Discipline Regime and how these regulatory changes will affect your securities' transactions settling in EU Central Securities Depositories (CSDs).

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Section A. Background to the CSDR

A1. What is CSDR and the Settlement Discipline Regime it's introducing?

CSDR is the European Central Securities Depository Regulation. It was first introduced in 2014 and aims to strengthen and standardise the European securities settlement framework, improve settlement efficiency and lower securities settlement fails within EU CSDs.

From **1 February 2022** some new settlement discipline measures will apply:

- Penalties for late settlements of securities (see Section D)
- A Mandatory Buy-In regime (see Section E)
- Allocations and Confirmations (see Section F).

Due to ongoing developments with the European Commission and the European Securities and Markets Authority, the regulations could change and certain aspects of the CSDR settlement discipline regime may be delayed. If there are any changes, we'll change our terms of business to reflect these and will let you know.

A2. What settlement fails do penalties and mandatory buy-ins apply to?

(a) What requirements must be met?

There are 3 requirements:

1. The type of securities must be:
 - Transferable securities, such as bonds or shares
 - Money-market instruments, such as commercial paper and certificates of deposit
 - Units in collective investment undertakings (UCITS), such as exchange traded funds
 - Emission allowances.
2. The type of securities above must also be traded on or admitted to trading on EU trading venues or cleared by EU central clearing counterparties (CCPs).
3. The securities must settle in an EU CSD.

(b) When do these requirements not apply?

Penalties and buy-ins don't apply to shares which are principally traded on trading venues outside the EEA. Please also read paragraph (e) below of this section which mentions short-term securities financing transactions.

The European Commission is expected to feedback later in 2021 and this exemption could be extended to debt securities principally traded on trading venues outside the EEA.

(c) If we're outside the EU, will penalties and buy-ins apply to my transactions?

Yes, if your transaction meets the requirements in A2(a) above.

(d) Does settlement discipline apply to cash transactions and master agreement transactions?

Yes, when they meet the requirements in A2(a) above.

(e) Does this include deliveries under securities financing transactions (repos and securities lending)?

Yes, penalties and buy-ins apply to the securities deliverable under repurchase (repos) and securities lending agreements. Securities financing transactions (SFTs) which mature less than 30 days after the initial SFT leg are excluded from the buy-in regime.

(f) Are derivatives included in the settlement discipline regime?

Yes, where the derivative is physically-settled, whether it's an OTC or exchange traded derivative.

(g) Does settlement discipline apply to margin transfers under derivative and SFT master agreements?

As things stand currently, the Settlement Discipline Regime will apply to margin transfers under derivatives and SFTs. Industry associations have lobbied ESMA and the EU Commission to exclude margin transfers from the regime so this may change in the future.

Section B. What's changed since the United Kingdom left the EU?

B1. Does settlement discipline apply to settlements in CREST?

No, the settlement discipline doesn't apply to settlements of inbound securities into CREST.

Section C. Will our contracts be updated?

C1. Will my terms of business be updated?

Yes, your terms of business have been updated via the terms of business CSDR Annex to reflect the Settlement Discipline Regime changes.

C2. If I have master trading agreements with you, will these be updated?

Yes, we've included standard terms in our master trading agreements to reflect these changes. Clients with master agreements will need to sign a CSDR Amendment Agreement to comply with the Settlement Discipline Regime.

Section D. The Penalties Regime

D1. What transactions do penalties apply to?

Penalties apply to unmatched instructions and settlements failing after the intended settlement date in EU CSDs. The settlements and instructions relate to securities which are either: (a) admitted to trading or traded on an EEA trading venue or cleared by an EU CCP. So, penalties also apply to the failed delivery of securities under the individual legs of master trading agreements.

D2. When do penalties apply?

Parties failing to match instructions or settle securities transactions in an EU CSD by the intended settlement date must pay a daily penalty for each day instructions are either not matched or the settlement fails after the intended settlement date.

Penalties will continue to be charged until the first to occur of:

- Settlement
- Transaction cancellation
- A buy-in takes place
- The payment of cash compensation.

D3. How much are the penalties?

The table below includes the current daily penalty rates:

	Relevant financial instrument	Daily penalty rate (in basis points)
1.	Shares that have a liquid market	1
2.	Shares that don't have a liquid market	0.5
3.	SME growth market instrument (excluding debt instruments)	0.25
4.	Sovereign/ central bank/ local government/ European multilateral development bank/ European Financial Stability Facility or the European Stability Mechanism issued and guaranteed debt instruments	0.10
5.	Debt instruments (other than sections 4 and 6 of this table)	0.20
6.	Debt instruments traded on an SME growth market	0.15
7.	All other financial instruments	0.5
8.	Failure due to lack of cash	Official interest rate for overnight credit charged by the central bank issuing the settlement currency with a floor of 0.

For more information, you can read the European CSD Association's (ECSDA) CSDR Penalties Framework at ecsda.eu/wp-content/uploads/2021/01/2020_12_18_ECSDA_CSDR_Penalties_Framework_updated.pdf. This has more detail on the scope and penalties calculation methods along with full details of instruments that CSDR apply to.

D4. What instructions and settlements are outside of the penalties regime?

Currently, the following instructions or associated settlements are excluded from the penalties regime:

- Instructions for settlement in a non-EU CSD (i.e. DTC, SIX-SIS)
- Instructions where the ISIN isn't included on the EU CSD eligible MIFID II/MiFIR securities database (FIRDS Register)
- Instructions where the underlying ISIN is a share which is principally traded outside the EU
- Any matched settlement instructions which are cancelled by the end of the intended settlement date
- Any unmatched instructions which are pending or cancelled on or after the intended settlement date.

Section E. The Buy-in Regime

E1. What's a CSDR buy-in?

A buy-in is a request to an independent EU investment firm to source securities on a 'best execution' basis for a party who hasn't received settlement by a given 'extension period' after the intended settlement date. The 'buy-in agent' has a defined period to source the requested securities.

E2. What's the trigger for a buy-in and how long does it last?

A 'buy-in' may happen for any in scope settlement fail after the end of the 'extension period'. The buy in period has the following timeframes in business days:

- **4** for liquid shares
- **7** for all other instruments.

E3. What's an 'extension period'?

An 'extension period' is a settlement grace period expressed as a number of business days after the intended settlement date. The number of business days is:

- **4** for liquid shares
- **7** for debt securities
- **15** for SME growth market securities.

E4. When should I use a buy-in agent?

If you haven't received your securities by the last day of the relevant extension period, you should instruct your buy-in agent on the following business day to source your securities. To do this, you'll need to engage a buy-in agent, preferably under contract, to cover the securities markets where you settle in EU CSDs.

The buy-in agent should be an independent EU investment firm which can source the securities, where possible. There are currently limited buy-in agent services offered in the market.

E5. How's the buy-in handled?

There are two scenarios below and you'll need to respond differently depending on the outcome:

- (a) **Your buy-in is successful.** You pay the buy-in agent for delivering the securities and can request from the failing counterparty to pay any increased costs. The original transaction settlement instructions should be cancelled at your CSD.
- (b) **Your buy-in isn't successful.** You have the following options:
 - (i) You can request the failing counterparty to pay you cash-compensation to put you in the same economic position as if the original transaction had settled or
 - (ii) You may start a 'deferral period' and request a second and final buy-in. A 'deferral period' has the following timeframes in business days: **4** for liquid shares and **7** for all other instruments.

You can read this AFME document which has an example of the penalties and buy-in process at afme.eu/Publications/Reports/Details/detail/Introduction-to-CSDR-Settlement-Discipline

E6. What are partial settlements?

A partial settlement is when the failing settlement party agrees to settle less than the notional amount specified in the settlement instruction.

The failing party must settle any securities they have by the end of the 'extension period'.

(a) Will a partial settlement lower the amount of penalties the failing party needs to pay?

Yes, as penalties will apply only on the value of the unsettled part of the transaction.

E7. Which settlements are excluded from the buy-in obligation?

The regulations exclude failed settlements in the following situations:

- The failing trading party has become insolvent
- The relevant financial instruments no longer exist or have been suspended from trading
- The majority of corporate actions (bonus share issuances)
- Transactions in shares where their primary trading venue is outside the EU
- Short-term (i.e. less than 30 day maturity) securities financing transactions (i.e. repos and securities lending).

E8. What do I have to do to get ready for partial settlement requirements?

You should be able to send and receive any settlement on a partial basis, either on the intended settlement date, or if later, by the end of each 'extension period'. You should also be able to receive partial settlements if a buy-in results in a partially-settled transaction.

This will mean your systems will need to be able to process partials in both directions. You should communicate with both your CSDR project team and your custodian to talk about the functionality that you need.

E9. What additional functionality will I need for my settlement instructions?

You'll need to be able to cancel or modify certain instructions to deal with partial settlements. You also need to be able to use hold and release functionality for your settlement instructions, when needed.

Hold and release functionality allows a party to temporarily put a settlement instruction on hold, even if the cash or securities are available and to release it only when settlement is desired.

E10. How do the 'compensation' payments work for buy-ins?

Where the buy-in takes place at a price higher than the original transaction, you may claim the difference from the failing settlement party by invoicing the costs. The payment of these invoices should be paid no later than 2 business days from receipt of the invoice.

E11. What's the effect of the buy-in requirement on settlement chains?

Currently, there's no way to know where a given transaction is connected to other transactions in a settlement chain. This means that buy-ins will have to take place for each failing transaction within the settlement chain. This may negatively affect the liquidity and price of the relevant security where multiple buy-ins are done for the same security in a settlement chain.

Section F. Allocation and Confirmations**F1. What are Allocations and Confirmations under CSDR?**

'Allocations' are written instructions to settle cash or securities into a cash or custody account and include certain regulatory information needed by the CSDR Regulatory Technical Standards (2018/1229) (RTS).

'Confirmations' are confirmations of receipt of the allocation instruction.

F2. When does it apply to us as a counterparty to LBCMW?

As a professional client facing LBCMW, there are some scenarios where you need to send us either written or electronic pre-settlement allocation instructions.

These scenarios are:

- When you want to instruct us to allocate your settlements across various accounts or sub-accounts for a block trade
- When you want to change your settlement account(s) or Standard Settlement Instructions (SSIs).

F3. When should we send you allocation instructions?

If you need to send us a pre-settlement written allocation instruction, the timing will depend on where you're geographically located:

- If you're in the same time-zone (CET) as us, it will be by close of business on the transaction date
- If (a) the transaction occurs after 16:00 CET or (b) the time difference is more than 2 hours between us, then it will be by 12:00 CET on the business day following the transaction date.

F4. What do we need to include in the allocation instruction?

Please read the schedule in the Terms of Business CSDR Annex.

F5. If I use CTM, what do I need to do?

You don't need to change how you use CTM. CTM will act as an allocations and confirmations tool.

F6. What is the LBCMW position on Allocations and Confirmations?

We've updated our Terms of Business so that:

- No exchange of written allocations is needed
- No confirmation of receipt of the allocation instruction is needed
- No confirmation of transaction terms is needed under the Settlement Discipline Regime,

provided you send us the settlement and transaction information we need on time.

Please send us any allocation instructions electronically where possible. You can also send us written allocation instructions by email.

F7. What if my SSIs change?

You'll still need to tell us if you change your SSIs so that we can settle transactions to your correct custody account and that allocations and confirmations requirements can be met.

